

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF CAPITOL WATER)
CORPORATION'S APPLICATION FOR A) CASE NO. CAP-W-02-1
TEMPORARY SURCHARGE, A)
DECLARATION OF PRUDENCY, AND)
AUTHORITY TO INCUR DEBT TO FUND) ORDER NO. 29035
SYSTEM IMPROVEMENTS.)
_____)**

On February 26, 2002, Capitol Water Corporation (Capitol Water; Company) filed an Application requesting the Commission issue an Order that declares its proposed capital expenditures prudent, authorizes the Company to incur debt to fund the improvements, and institutes a temporary seven-year surcharge to recover the cost from customers. The Commission authorized Capitol Water in 1997 to collect a surcharge of \$3.27/month from unmetered residential customers and to implement a 25.2% increase for metered commercial customers over a seven-year period ending August 1, 2004 to fund water quality improvements. Order No. 27022. To fund proposed capital improvements, the Company now seeks to add a second surcharge of \$3.56/month for unmetered residential customers and implement a 21.1% increase for metered commercial customers.

In the Notice of Application and Modified Procedure issued on March 28, 2002, the Commission solicited comments regarding Capitol Water's Application. Order No. 28980. No written comments were received other than those submitted by Commission Staff, to which the Company responded on April 22, 2002. In this Order the Commission grants Capitol Water's Application and authorizes collection of a \$3.10/month surcharge for unmetered residential customers and a 23.6% increase for metered commercial customers, subject to various reporting requirements.

THE APPLICATION

Capitol Water's Application directly or indirectly requests the Commission to issue an Order that declares the proposed capital expenditures prudent, authorizes the Company to incur debt to fund specified improvements, and institutes a temporary surcharge to recover the cost from customers.

Capitol Water serves approximately 2,800 customers in an area of approximately four square miles in west Boise. It is bounded roughly by Northview Street on the south, Ustick Road on the north, North Maple Grove on the west, and Curtis Road on the east. The system has seven wells, two of which have been abandoned. Capitol Water has no storage reservoirs.

A. Declaration of Prudence

Recognizing the need to ensure customer health and safety by correcting flow and pressure deficiencies, Capitol Water intends to focus its capital improvements on replacing Well No. 5 and upgrading its distribution system. Because the Company believes the expenses incurred to date and the proposed expenditures would be in the public interest, Capitol Water specifically requests a Commission Order “declaring that the incurrence of these expenses is a prudent capital investment.” Application at 5.

1. Well 5 Replacement.

The eastern portion of the Company’s water system includes the approximately 420 customers located east of Fry Street. This area was historically supplied by Well Nos. 1, 2, and 5, which originally had a combined capacity of 1,700 gallons per minute (gpm). Based on Idaho Department of Environmental Quality (DEQ) criteria for estimating system demand for metered public water systems, the anticipated peak hour demand for this area is approximately 1,091 gpm. *Id.* at 2. Because DEQ recommends doubling the estimate for unmetered systems such as Capitol Water’s, peak-hour demand could exceed 2,000 gpm. *Id.* In addition to normal peak demands, fire flow requirements for public safety are 1,500 gpm. *Id.* Thus under a worst-case scenario, peak hour demand could exceed 3,500 gpm. *Id.*

Well No. 2 has failed due to casing collapse and Well No. 5 was abandoned in 2000 due to perchloroethylene (PERC) contamination. Well No. 1 is more than 40 years old, and has a capacity of just 350 gpm. It is typically only used during summer months due to high levels of iron and manganese. Company Well Nos. 3, 4, 6 and 7 located in the western portion of Capitol Water’s service area currently supplement the water drawn from Well No. 1. In the winter months, water for the eastern portion of the Company’s system is supplied entirely from the Company’s Well Nos. 3 and 7. The combined capacity of Well No. 1 and the deliverable capacity of Well Nos. 3, 4, 6, and 7 leave a peak hour demand shortfall of 1,050 gpm, and a shortfall of approximately 2,050 gpm to meet recommended fire safety flows during peak summer hour demand. *Id.* at 3.

Capitol Water plans to replace Well No. 5 as soon as possible to provide adequate water supply for fire protection and peak hour demands. The replacement well will be located on the same site and will seal off the contaminated shallow aquifer zones. *Id.* The replacement well will tap aquifer zones that are believed to have good water quality with respect to iron and manganese, and only residual levels of dissolved PERC. *Id.* The residual levels of PERC are anticipated to diminish over time as the well is pumped. *Id.* Based on the Company's current system capacity and customer demand, a well sized to produce approximately 1,000 gpm is needed to replace abandoned Well No. 5. *Id.* The Company proposes servicing this well with a 100-horsepower, variable speed, line-shaft turbine pump rated to produce 200 to 1,000 gpm. *Id.* Although the cost to replace Well No. 5 is projected to be \$346,000, the Company also seeks to recover the \$45,349.66 it has already expended to date for costs associated with the abandonment of old Well No. 5. *Id.* at 4.

2. Distribution System Upgrades.

The eastern portion of the Company's service area is connected to the western portion by three 4-inch mains. These connections are located at the intersections of Pomona Road and Fry Street, Newman Street and Norman Drive, and Northview Street and Fry Drive. At five feet per second velocity, approximately one pound per square inch of pressure (psi) is lost for every 100 feet of four-inch pipe. Based on this calculation, a maximum supply of approximately 600 gpm can be delivered from the western portion of the system to the eastern portion. *Id.* at 3.

At flow rates in excess of 600 gpm, delivery pressure in the current system may decline to unacceptable levels (i.e., below 35 psi). *Id.* The limited deliverable capacity of Well Nos. 3, 4, 6, and 7 from the western service area contributes to the peak hour demand shortfalls described above. To ensure adequate distribution capacity, the Company plans to complete a system-wide hydraulic map and model. *Id.* at 4. Based on current knowledge, it is estimated that the distribution capacity upgrade will require installation of approximately 2,000 feet of eight-inch pipe. *Id.* Although the distribution upgrade is projected to cost \$90,000, the Company also seeks to recover the \$13,874.96 it has spent thus far on new distribution system connections in the Well No. 5 service area following abandonment of the well. *Id.*

3. Legal Expenses

Because Capitol Water is a small company, the Company contends that the cost of preparing and processing this Application will represent a significant extraordinary expense. *Id.* The

Company estimates that the legal and accounting costs associated with this Application will be approximately \$12,500. *Id.* Capitol Water requests that it be allowed to recover its actual expenses for processing this rate case out of the proceeds of the temporary rate increase.

B. Authority to Incur Debt

Under Idaho Code, a regulated water utility like Capitol Water must receive authorization from the Commission to incur long-term debt with respect to its property situated in Idaho. *Idaho Code* § 61-901. To make the capital investment necessary to provide adequate water supply and distribution, Capitol Water proposes to borrow \$507,000 at 7.08 percent over seven years. *Id.* at 4 and Exhibit 104. Under this borrowing arrangement, the Company would be required to repay \$92,061.96 each year. *Id.*

C. Temporary Surcharge

To recoup the costs of its capital investments, the Company requests that the Commission approve a seven-year temporary surcharge. This surcharge is in addition to the previously approved \$3.27/month surcharge for unmetered residential customers and 25.2% surcharge for metered commercial customers that will expire on August 1, 2004.

Capitol Water proposes that a \$3.56 per month charge be added to the base monthly rate for residential customers under rate Schedule No. 1. Schedule No. 1 is applicable to all non-metered customers for domestic use and lawn sprinkling. When combined with the current 3% franchise tax, this proposed temporary surcharge would increase the flat monthly base rate of non-metered residential customers by \$3.66. Exhibit 106 at 1. Thus the monthly rates of customers served by ¾" lines would increase from \$12.62 to \$16.28 during the months of October through April. *Id.* Residential customers served by 1" lines would see their monthly base rate increase from \$14.47 to \$18.14 during the months of October through April. *Id.* Customers served by 1¼" lines would likewise experience a rate increase from \$15.72 to \$19.38 during the months of October through April. *Id.* The additional monthly sprinkling rates of \$11.40 during the months of May through September are unchanged by this surcharge Application.

The Company also requests a 21.1% increase in the rates for metered commercial customers taking service under the Company's rate Schedule No. 2. If approved as requested, the first 1,000 cubic feet per month would increase from \$1.06 to \$1.24 per 100 cubic feet. The next 1,000 cubic feet per month would increase from \$0.60 to \$0.70 per 100 cubic feet. The rate for any

additional consumption would increase from \$0.45 to \$0.53 per 100 cubic feet. When combined with the current 3% franchise tax, this proposed increase would also raise the monthly minimum charge as follows:

SERVICE LINE SIZE	CURRENT MONTHLY MINIMUM CHARGE	PROPOSED MONTHLY MINIMUM CHARGE
¾" AND SMALLER	\$7.50	\$8.76
1"	\$10.40	\$12.10
1 ½"	\$15.00	\$17.46
2"	\$25.65	\$29.92
3"	\$45.75	\$45.75 (no change)

Exhibit 106 at 2.

D. Procedural Matters

The Company intends to maintain a separate balancing account on its books with all transactions related to the Application flowing through the account on a monthly basis as transactions occur. *Id.* at 5. Its Application states that none of the expenditures proposed in their Application will be recorded to the Company's plant accounts and the Company will not seek to add these costs to its rate base for ratemaking purposes. *Id.* Capitol Water also states that it will file written quarterly status reports to apprise the Commission of monies expended, construction progress and any testing results. *Id.*

Citing the limited scope of the issues presented in its Application, Capitol Water requests that its Application be processed without a hearing under Commission Rule of Procedure 202. *Id.* The Company did not propose an effective date.

STAFF COMMENTS

1. Source Replacement (Well 5)

The Company's Application proposed construction of a new well and well house at the abandoned Well No. 5 site on the eastern portion of the system. According to Staff, this location would provide a source where the supply need is the greatest. Staff Comments at 2. The Company's consultants, Scanlan Engineering and Hydrologic, performed a preliminary system analysis and groundwater study. The consultants analyzed the groundwater contamination and believe that the upper aquifer contamination should not detrimentally affect a new properly constructed supply well in this location. *Id.*

According to Staff, the Company's consultants project a minimum additional supply requirement of 1,050 gpm and a worst-case requirement of 2,050 gpm for the system. *Id.* They also estimate 1,000 gpm is reasonable to expect from a well drilled at the Well No. 5 location. *Id.* Because the new well will not completely provide all of the calculated extreme requirement for the eastern portion of the system, the consultants recommend pipeline improvements with this proposal and possible reconstruction of Well No. 2 in the future. *Id.* at 2-3.

Based on its analysis, Staff found that additional water supply is needed because of the considerable water capacity shortage in the eastern portion of the Company's system. *Id.* at 3. Staff agreed that the next logical improvement is to increase the transmission capacity associated with Well No. 5 as the Company proposes. *Id.*

2. Other Requested Funding

Staff agrees that some mainline improvement is probably necessary but cannot adequately assess the need or cost without further information. *Id.* Staff recommends that the Company conduct its network analysis and submit improvement recommendations before proceeding with any further mainline improvements. *Id.*

Staff reviewed the estimated costs for abandoning old Well No. 5, constructing a new Well No. 5, performing additional studies, and submitting Commission case filings. Staff believes the Company's system improvement proposal is reasonably based on sound technical advice and recommends that the Commission approve the plan and find the estimated costs to be reasonable subject to several conditions. *Id.* at 4. Although Staff believes it is reasonable to include the portion of mainline improvements proposed in this filing to minimize finance costs and facilitate the timely construction of the improvements, Staff recommends that any monies for mainline improvements other than those directly associated with Well No. 5 should be held until the Commission has an opportunity to review the network study and approve recommended mainline upgrades. *Id.* Staff also recommended the Company file quarterly status reports that summarize the status of studies, proposed designs and construction schedules in addition to the Company's proposed quarterly financing status reports. *Id.*

3. Surcharge Calculation

Staff reviewed the calculations made by the Company to develop an appropriate customer surcharge to fund the construction activities. According to Staff, the Company's calculations were

intended to duplicate the approach proposed by Staff and approved by the Commission in Case No. CAP-W-96-2. That case was a similar request for a customer surcharge to pay for backbone system improvements. However, Staff found that Exhibit No. 105 attached to the Application does not recognize interest expense and depreciation expense deductions for income taxes as indicated. *Id.* Staff also believes that the Company inappropriately allocated costs between flat rate residential customers and metered commercial customers. *Id.*

Staff recalculated the required surcharge and determined the effect on the Company's customers. Staff also updated the cost of borrowed funds in these calculations to reflect the 7.46% offered by the Bank of America on April 5, 2002. In doing so, Staff's calculations produced a surcharge of \$3.07 per month for residential flat rate customers instead of the \$3.56 surcharge calculated by the Company. *Id.* at 5. Staff's calculations also produced a surcharge of 23.6% for the Company's metered customers as compared with the 21.1% calculated by the Company. *Id.* The 3% Boise City franchise tax would add \$0.10 to the residential flat rate customer surcharge, bringing the total effect of the surcharge to \$3.17. *Id.* The franchise tax would also increase the commercial metered surcharge by 0.71%, bringing the total effect of the surcharge to 24.3%. *Id.*

Staff also calculated the effect on customers' bills of both the 1996 surcharge and the proposed surcharge in this case. The majority of residential customers use ¾ inch service lines and would see an increase in their basic rates (without 1996 surcharge) of 13.33% in the six summer months and an increase of 25.72% during the six winter months. *Id.* Staff noted that on an annual basis the increase for these customers would be 19.53%. *Id.* Since commercial metered customers are not on seasonal rates, their uniform annual increase is 23.60%. *Id.*

4. Accounting Issues

Staff stated that the Commission, in Order No. 27022 in Case No. CAP-W-96-2, directed Capitol Water to establish a balancing account on its books and flow all transactions related to the 1996 surcharge through the balancing account. *Id.* Instead, Staff asserted that the Company opened a separate bank account, into which all surcharges collected and bank loan proceeds from the 1996 surcharge have been deposited. *Id.* at 6. When payments were required to pay for improvements or make loan payments, the Company transferred funds from the special bank account to its regular checking account from which checks have been written to make the payments. Payments made for system improvements have been recorded to the Company's regular plant accounts. Consequently,

Staff found it very difficult to identify the special project investments that are not to be included in the Company's rate base. *Id.*

Upon discussing this problem with the Company, Staff and Capitol Water agreed that the Company must perform an analysis of its past activities to determine the amounts incorrectly recorded to each of its plant accounts. *Id.* Staff proposed that the Commission reiterate its instructions to the Company in this case to establish a balancing account on its books for all future surcharge activities. *Id.* Staff also recommended that the Company be instructed to complete its analysis of its plant accounts and furnish to the Commission, for its approval, correcting entries to remove the investments recorded in error from the prior surcharge authorized in Case No. CAP-W-96-1. *Id.*

COMPANY REPLY COMMENTS

In a response Fax to Staff's counsel on April 22, 2002, Capitol Water indicated that it is in agreement with all of Staff's recommendations. However, in regard to the odd amount of the increase, the Company asked that the amount of the \$3.07 surcharge be changed to \$3.10 for easier recordkeeping.

PUBLIC COMMENT

Although the Commission did not receive any written comment from the public, Staff received one phone call from a Capitol Water customer. This customer did not complain about the costs and still believed that Capitol's rates are reasonable. However, the customer noted that the Company's bill stuffer was silent regarding the percentage increase represented by the proposed flat \$3.56 surcharge to residential customers but indicated a 21% increase to metered residential customers.

COMMISSION FINDINGS

The Commission has reviewed the filings of record in this case and makes the following findings:

1. Declaration of Prudency: The Company seeks an order declaring certain expenses for water system improvements to be prudent capital investments that can be duly recovered from ratepayers. The Commission has reviewed the expenses (proposed and thus far incurred) to replace Well No. 5, upgrade the distribution system and prepare an interim surcharge request. We find the engineering reports and analyses filed by the Company and Commission Staff provide us with a

factual basis to conclude that the Company's proposal for improving its water system is sound. Capitol Water and Scanlan Engineering have identified water capacity deficiencies in the eastern portion of the system that limit the Company's ability to meet fire safety flows and peak hour demand. The record also indicates that delivery pressure in the current system may decline to an unacceptable level without upgrading the system's distribution capacity. As the only other party in this case, Commission Staff did not object to recovery of expenses to replace Well No. 5, upgrade the distribution system or recover legal expenses, and also found them to be appropriate. *Id.* at 2-3.

Based on the evidence before us, we find recovery of the proposed costs to remedy these water capacity issues to be reasonable. To this end, we approve the proposed investment detailed in Company's Exhibit Nos. 101-103. Likewise, the Commission authorizes Capitol Water to recover its reasonable legal and accounting expenses associated with this filing in an amount approximating \$12,500. A separate schedule showing the final amount associated with the legal and accounting expenses shall accompany the Company's first quarterly filing with the Commission.

As proposed in its Application, the Company shall submit written quarterly status reports to appraise the Commission of monies expended, construction progress and any testing results. Capitol Water shall also submit the proposed network analysis and any further improvement recommendations prior to proceeding beyond the improvements directly associated with the proposed new Well No. 5 installation. We also direct the Company to include in its Annual Report filing with the Commission a schedule depicting the status of the loan balancing account from inception to date and the remaining loan balance.

2. Authority to Incur Debt: To facilitate the financing of these improvements, Capitol Water requests authority to incur approximately \$507,000 in debt to cover the capital investment expenditures until the costs are recovered from ratepayers. The Company proposes to borrow these funds from Bank of America and repay the amount over seven years with revenue collected from a customer surcharge. For this loan, the Bank of America quoted Capitol Water an interest rate of 7.08% on February 6, 2002 and 7.46% on April 5, 2002.

The Commission finds that it is necessary and appropriate for Capitol Water to borrow \$507,000 to fund capital improvements. The general purposes to which the proceeds will be put are lawful under the Public Utility Law of the State of Idaho and are compatible with the public interest.

Therefore, the proposed seven-year loan from Bank of America is approved. Capitol Water shall file the final loan documents with the Commission when completed.

3. Temporary Surcharge: The Company has requested that the cost of the proposed improvements be recovered by a seven (7) year temporary surcharge identified as a separate line item on monthly billings. Capitol Water proposes that a \$3.46 per month surcharge be added to the base monthly rate for non-metered residential customers and a 21.1% rate increase for metered commercial customers. This new surcharge would be in addition to the previously approved \$3.27 per months surcharge for unmetered residential customers and 25.2% surcharge for metered commercial customers that will expire on August 1, 2004. Order No. 27022.

Staff did not agree with the calculations used by the Company to formulate an appropriate surcharge. Staff found that Capitol Water 1) did not recognize interest expense and depreciation expense deductions for income taxes and 2) inappropriately allocated costs between flat rate residential customers and metered commercial customers. Staff Comments at 4. Thus, Staff recalculated the required surcharge and updated the cost of borrowed funds in these calculations to reflect the 7.46% offered by the Bank of America on April 5, 2002. *Id.* Staff's calculations resulted in a surcharge of \$3.07 per month for residential flat rate customers and a surcharge of 23.6% for the Company's metered customers. *Id.* at 5.

Since Capitol Water's Reply indicated that it was in agreement with all of Staff's recommendations, the Commission presumes that the Company does not oppose Staff's recalculations. However, the Company asked that the amount of the \$3.07 surcharge be changed to \$3.10 for easier recordkeeping. The Commission agrees that a round surcharge number is preferable in this instance. Given our review of the record and the apparent agreement of the parties, we find that a \$3.10 per month surcharge for unmetered Schedule No. 1 residential customers and a 23.6% surcharge for metered Schedule No. 2 commercial customers to be fair and reasonable.

As recommended by Staff and to facilitate any audit, Capitol Water shall create a separate balancing account on the Company's books with all transactions related to this surcharge flowing through the account on a monthly basis as transactions occur. We limit recovery to the authorized amounts, i.e., a principal loan amount of \$507,000.

4. Accounting Issues: The Commission, by Order No. 27022 in Case No. CAP-W-96-2, directed Capitol Water to establish a balancing account on its books and flow all transactions related

to the 1996 surcharge through the balancing account. As noted above, Staff comments stated that the Company did not follow the Commission's instructions and instead opened a separate bank account. *Id.* at 6. The result was that expenditures for capital improvements were commingled with regular plant expenditures that are recovered in a rate case rather than through a temporary surcharge.

The Commission finds it is imperative that Capitol Water account for its system improvements separately from its regular plant expenditures that are to be included in rate base. To correct its bookkeeping, the Company shall complete its analysis of its plant accounts and file corrected entries that remove the investments recorded in error from the prior surcharge authorized in Case No. CAP-W-96-1. The Company shall file its analysis and proposed correcting entries with the Commission no later than December 31, 2002.

CONCLUSIONS OF LAW

The Commission has jurisdiction over Capitol Water Corporation, a water utility, and the issues raised in Case No. CAP-W-96-2 pursuant to the provisions of Idaho Code Title 61 and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

ORDER

IT IS HEREBY ORDERED and Capitol Water Corporation is authorized to incur indebtedness in the principal amount of \$507,000 for the purposes described in its Application and implement a \$3.10 residential flat rate surcharge and a metered commercial surcharge of 23.60%. The Company is directed to account for the authorized expenditures in the manner described above. The Company is further directed to file the final loan documents and compliance tariffs with the Commission Secretary.

IT IS FURTHER ORDERED that Capitol Water Corporation shall submit written quarterly status reports to appraise the Commission of monies expended, construction progress and any testing results. The first quarterly report shall also include a separate schedule detailing the final legal and accounting expenses associated with this filing. We also direct the Company to include in its Annual Report filing with the Commission a schedule depicting the status of the loan balancing account from inception to date and the remaining loan balance.

IT IS FURTHER ORDERED that Capitol Water file with the Commission the proposed network analysis and any further improvement recommendations prior to proceeding beyond the improvements directly associated with the proposed new Well No. 5 installation.

IT IS FUTHER ORDERED that Capitol Water establish a balancing account on its books to track all financial activity associated with its surcharge.

IT IS FURTHER ORDERED that the Company shall complete its analysis of its plant accounts and file corrected entries that remove the investments recorded in error from the prior surcharge authorized in Case No. CAP-W-96-1. The Company shall file its analysis and proposed correcting entries with the Commission no later than December 31, 2002.

THIS IS A FINAL ORDER. Any person interested in this Order may petition for reconsideration within twenty-one (21) days of the service date of this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

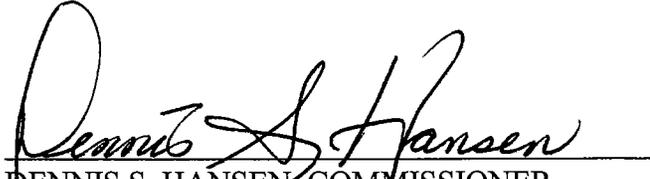
DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho, this 22nd day of May 2002.



PAUL KJELLANDER, PRESIDENT

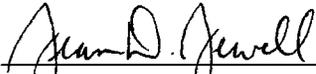


MARSHA H. SMITH, COMMISSIONER



DENNIS S. HANSEN, COMMISSIONER

ATTEST:



Jean D. Jewell
Commission Secretary

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