Office of the Secretary
Service Date
October 12, 2012

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF FALLS WATER COMPANY FOR AN ORDER AUTHORIZING INCREASES IN THE COMPANY'S RATES AND CHARGES FOR WATER SERVICE	**CASE NO. FLS-W-12-01** **ORDER NO. 32663**

On January 30, 2012, Falls Water Company applied to the Commission for authority to increase its rates and charges. Falls Water provides water service to more than 3,900 residential and commercial customers north of the City of Ammon and northeast of the City of Idaho Falls in Bonneville County. The Company last increased its basic rates and charges in March 2010. Order No. 31022. With this Application, the Company asks to increase the revenues it receives from rates by $295,059.75 (about 26.5%), for a new total revenue requirement of $1,407,671.

We have thoroughly reviewed the record in this case, including written comments and analysis from the Company, Commission Staff, and the Company's customers, and testimony from customers given in a public hearing. Based on that review, we approve a new, total revenue requirement for the Company of $1,257,158. The Company's new rates and charges will take effect on October 16, 2012.

PROCEDURAL BACKGOUND

On February 22, 2012, the Commission suspended the proposed effective date for the schedule of rates and charges to August 28, 2012. Order No. 32467, *Idaho Code* § 61-622. On March 16, 2012, the Commission issued a Notice of Public Workshop, Notice of Modified Procedure, and Notice of Public Hearing setting comment and reply deadlines, a public workshop, and a customer hearing. *See* Order No. 32487 and corresponding Errata. The workshop and customer hearing occurred, Staff and members of the public filed written comments, and the Company filed a written reply. The Staff then filed an issue-narrowing surreply per Commission Order, and the Commission suspended the Company's schedule of rates and charges until October 16, 2012. *See* Order Nos. 32626 and 32642.

THE APPLICATION

In its Application, the Company said that after its last rate case it: (1) replaced manually-read meters with new touch-read meters and installed radio transmitter units (MXUs) on all meters not already so equipped; (2) doubled its rented office and warehouse space; and (3) added an on-line billing option (Xpress Bill Pay) for customers. Application at 2. These and other expenditures have led the Company to apply to raise rates and increase revenues. *Id.* at 1, 4. The Company proposed to increase customer rates and decrease the corresponding volume of water allowed as follows:

Customer Monthly Charges (Base Rate Charges)

Meter Size (inches)	Present Rate ($/month)	Present Volume Allowance (gallons)	Proposed Rate ($/month)	Proposed Volume Allowance (gallons)	Percent Increase (%)
¾ - inch or smaller	$16.10	12,000	$19.18	5,000	19.1%
1-inch	$22.54	17,000	$26.85	7,000	19.1%
1 ½ - inches	$28.98	22,000	$34.52	9,000	19.1%
2 – inches	$37.03	28,000	$44.11	12,000	19.1%
4 - inches	$66.01	49,000	$78.64	20,000	19.1%

Commodity Charges

Customer Class	Current Rate ($/1,000 gallons)	Proposed Rate ($/1,000 gallons)	Percent Increase (%)
All Customer Classes	$0.611	$0.670	9.7 %

See id.

The Company says this rate design will yield $1,407,749.70 in revenues, which is within $78.59 of the requested, $1,407,671.11 revenue requirement. *Id.* The Company estimates that the average, 3/4″ metered-customer's bill will increase 26.8%; the average 1″ metered-customer's bill will increase 24.3%; the average 1 1/2″ metered-customer's bill will increase 26.1%; the average 2″ metered-customer's bill will increase 27.8%; and the average 4″ metered-customer's bill will increase 28.1%. *Id.* at 4-5.

Apart from the rate increase, the Company also proposes to read meters year-round. *Id.* at 5. The Company historically has read residential meters from April through October but not during the winter due to difficult meter access. However, the Company now can read meters year-round because it has installed radio-read meter units throughout its system. *Id.* The

Company notes that year-round reading would enable it to detect leaks sooner, thereby benefiting customers and conserving water. The Company also notes that customers would be able to pay for excess water used during the winter as the overages are incurred instead of having to wait for the Company to assess them for such use when it bills them in the spring. *Id.*

PUBLIC COMMENTS AND TESTIMONY

Numerous customers submitted written comments or testified in this case. Customers opposed the magnitude of the Company's proposed rate increase and the water allowance decrease. Customers noted that the Company should have gradually updated infrastructure so as not to inflict a sudden, extreme rate hike on customers, and that the Company should not have spent so much on meters without obtaining prior input from the Commission and customers. Customers also urged the Commission to scrutinize the Company's spending habits and operating costs, especially the Company's decision to increase building space and improve meter technology during a poor economy. Customers said the Company paid excessive rent, and that it incurred unnecessary mailing costs by distributing the customer notice separately from monthly bills.[1] Customers also said that the Company's customer notice soft-pedaled the proposed rate increase by omitting that the Company also was proposing a water-allowance decrease. In one public comment, and at the customer hearing, a few customers complained about low water pressure.[2]

Commission Decision: We appreciate the time that the Company's customers took to comment and testify in this case. We recognize that for some customers any rate increase will result in economic hardship. We also note that the Commission has an obligation to Falls Water and its customers to set rates at a level sufficient to allow the Company to recover its reasonable expenses and receive a reasonable return on its investments. Such rates enable the Company to remain financially sound and capable of providing adequate, safe water to its customers. That said, we note that Commission Staff raised many, similar issues in its comments and we will address those issues later in the Order.

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[1] Commission Rule 125 says that customer notices "may be mailed to customers as bill stuffers over the course of a billing cycle or may be contained in additional comment pages to the customer's bill." The rule contemplates that a company will mail customer notices with monthly bills.

[2] One customer commented that his water pressure was "really low." *See* Public Comment filed July 10, 2012. And at the customer hearing that night, three customers said pressure frequently was low; two customers said pressure was fine or low depending on whether use occurred during peak irrigation times; one customer said pressure was "pretty good" and that he had no complaints about pressure. *See* Tr. at 9-15, 17, 23-25, 28-30, 33.

With regard to the low-pressure issue, we note that customer views were mixed. On the day of the customer hearing, five customers said they had experienced low pressure in varying degrees at some point. It is unclear from the record why these pressure issues occurred and whether they were widespread or isolated incidents. We note that Commission Staff was present at the hearing and addressed the pressure issue with the Company. We expect the Company to diligently work to resolve any water pressure issues, and we encourage customers to contact the Company or Staff if they continue to experience low pressure. We also suggest the Company consider implementing a residential irrigation schedule if doing so would mitigate low pressure issues that might arise at peak-use times.

STAFF COMMENTS, COMPANY REPLY, AND SURREPLY

The parties' positions on (1) revenue requirement, (2) rate design, and (3) other issues are discussed below.

I. REVENUE REQUIREMENT

In this section we address revenue requirement issues including the appropriate test year and the expenses, rate base, and rate of return to be allowed.

A. Test Year

The Company proposed a 2011 test year, adjusted and normalized for known and measurable changes. Application at 2. Staff agreed with the Company's proposal. Comments at 25.

Commission Decision: Based on our review of the record and the parties' agreement on this issue, we find that a 2011 test year is reasonable and appropriate.

B. Expenses, Rate Base, and Rate of Return

1. Expenses. In its Application, the Company reported $933,351 in annual ordinary expenses, and $215,195 in net other expenses. Application Exhibit 2. Staff proposed disallowing certain of the Company's reported expenses related to depreciation expense, source of supply expense (costs for electric power and water testing and treatment), rental property expense, and rental equipment expense. These individual expense adjustments are discussed below.

a. *Depreciation Expense*. The Company's Application said the meter project increased depreciation costs by $84,210. Application at 3-4; Exh. 2, p. 2 l 52. The meter project that was completed in January 2012, has two parts: (1) the Company's investment to replace 604 old, manually read meters with new touch-read meters, as contemplated by prior Commission Orders; and (2) the Company's investment to install MXU radio transmitters on all meters not already so equipped.

In its comments, Staff said the Company miscalculated meter project depreciation and that, using the Company's methodology, the depreciation expense should have been $83,988. Staff said, however, that even this corrected figure is wrong because it relies on the Company's assumption that the meters have no salvage value and a 10-year depreciable life. Staff said the Commission should use the NARUC[3] standard—a 10% salvage value and at least a 35-year depreciable life—until the Company presents "reasonable, auditable, evidence demonstrating a basis" for using a shorter useful life. Staff then applied the NARUC standard to recommend that the Commission allow a $3,249 depreciation expense for the $126,336 in touch-read meter investment that Staff said should be included in rate base. Because Staff said the other portion of the meter project—the MXU investment—should not be included in rate base, Staff also recommended that the Commission disallow the remaining, $80,739 in MXU-related depreciation. Comments at 10 and 25 and Atch. E.

In its reply, the Company maintained that the Commission should let it recover depreciation for the entire meter project (i.e., on both the $126,336 investment in touch-read meters allowed by Staff, and on the $674,024 in MXU investment opposed by Staff), for a total meter project asset value of $800,360.[4] The Company then proposed adjusting depreciation by $28,766 based on a 25-year depreciable life and no salvage value, which the Company said were more realistic assumptions given its experience and the meter components. Reply at 5-6, Atchs. 8 and 9.

In its surreply, Staff accepted the Company's new proposal to assume a zero salvage value and a 25-year depreciable life, but only for the $126,336 in touch-read meter investment. Surreply at 2. Staff thus increased its originally recommended depreciation expense for the touch-read meter investment by $1,805, from $3,249 to $5,054. Surreply at 2.[5] Staff noted,

[3] National Association of Regulatory Utility Commissioners.

[4] Staff recommended disallowing the Company's claimed $713,542 in investment related to buying and installing 3,300 MXUs, consisting of $674,024 for the MXU units plus $39,518 for financing charges and temporary office labor. The Company's proposal accepts the recommended disallowance for financing charges and temporary office labor.

[5] Staff observed that the revised depreciation adjustment requires Staff to revise its recommended rate base and revenue requirement, and that the new revenue requirement would lead Staff to change its rate design.

however, that the actual useful life of the new metering technology is unknown. Staff thus recommended that the Company "keep maintenance and replacement records for each composite construction meter, to establish a reliable record to determine the useful life for this new enhanced type of meter." *Id.*

Commission Decision: Based on our review of the record and the parties' agreement on salvage value and useful life, we find that it is reasonable and appropriate for the Commission to use the parties' assumption of a zero salvage value and 25-year depreciable life when calculating meter project depreciation. We find it reasonable to require the Company to track meter maintenance and replacement as suggested by Staff so the Company can better document useful life for the meters.

b. Source of Supply Expense. In its Application, the Company reported increased electric power costs, water sample testing costs, and water chemical treatment costs. Application at 3, Exh. 2 Col. E. Staff accepted the Company's $2,725 adjustment to the test year water sample testing cost, but Staff recommended decreasing the Company's pro forma electric power cost by $18,535, and the pro forma water chemical treatment cost by $427. Comments at 11-12, 25. The Company concurred with Staff's recommendations. Reply at 8.

Commission Decision: Based on our review of the record and the parties' agreement on these issues, we find that the Company's $2,725 adjustment to the water sample testing cost, and the Staff's $18,535 adjustment to the Company's pro forma electric power cost and $427 adjustment to the pro forma water chemical treatment cost are reasonable and appropriate.

c. Rental Property Expense. In its Application, the Company asked to recover $4,255.30 in additional rental property expenses to reflect that it had increased its rented office and warehouse space. The Company claimed a total, adjusted property rental expense of $53,952. Application at 3, Exh. 2.

In its comments, Staff expressed concern that the Company had leased the additional space from its owner. Staff highlighted that the same issue arose in the Company's last rate case. There, the Company leased 4,000 square feet of the same building space from its owner. The Commission warned the Company about engaging in such related-party transactions, and directed the Company to prove that its lease was the product of arms-length bargaining. Comments at 12, *citing* Order No. 31022. In the instant case, Staff said the Company again seeks to recover expenses arising from a related-party lease. This time, the Company has again leased the original 4,000 square feet of building space from the owner, along with an extra 5,000 square feet. Staff said the Company has not demonstrated any savings or other economic benefits that might justify the new lease. Rather, the Company simply says it needs the extra space to conduct routine vehicle maintenance, to store inventory and a backhoe and dump truck that the Company also rents from the Company's owner, and to capture the benefits of consolidating its building sites together. *Id.* at 13. Staff recommended that the Commission allow only one-fifth of the expense related to the newly leased, 5,000 square feet of building space. This proposal decreases the Company's claimed office and warehouse rental expense by $11,957, from $53,952 to $41,995. *Id.* at 13-14, 25, Atch. G.

In its reply, the Company disagreed with Staff's recommendation. The Company said the Commission should allow it to claim one-half of the expense related to the newly leased, 5,000 square feet of building space.[6] The Company recommended the Commission decrease Staff's $11,957 adjustment to the claimed, $53,952 in annual rent by $8,992 to $2,965, for a total adjusted, annual property rental expense of $50,987 (i.e., $53,952 - $2,965). Reply at 9, Atch. 16.

Commission Decision: In the Company's last rate case, FLS-W-09-01, we advised the Company that it must prove that a related-party lease is reasonable and the product of arms-length bargaining before the lease costs can be included in rates:

> Staff notes that affiliate transactions are subject to close scrutiny and the regulated utility has an increased burden to prove the reasonableness of its affiliate transactions. For expenses to be justified there needs to be evidence of arm's length bargaining between the Company and the source of the expense. The burden of proof is on the Company to show that the costs incurred in the affiliate transaction are reasonable and beneficial to customers.
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> The Commission is genuinely concerned by the number of affiliate transactions that Falls Water engages in without apparent regard to providing evidence of arm's length bargaining. The Company has an increased burden of proving the reasonableness of the costs incurred in an affiliate transaction....

Order No. 31022 at 5.

[6] The Company said that only one-half of the additional lease expense should be allowed because the Company does not effectively use one-half of the newly rented, 5,000 square feet of space.

Here, the Company has again failed to carry its burden of proving that its lease with its owner is reasonable and the product of arms-length bargaining. Even if the Company's proffered reasons for needing the extra space are true (i.e., the Company needs the space for storage, maintenance, and convenience), those reasons do not establish that the lease terms are reasonable. The Company has not, for example, demonstrated what a comparable empty building would rent for in this poor economic climate. We find that Company's proposed, $53,952 in rental property expense is excessive, that Staff's recommended $11,957 adjustment to the rental property expense is reasonable, and that the Company will be allowed to recover through rates a total annual rental property cost of $41,995.

d. _Rental Equipment Expense._ In its Application, the Company reported a $31,474.28 rental equipment expense. Application Exh. 2, Col. H l 34.

In its comments, Staff noted that the Company rented the equipment (backhoe and dump truck) from the Company's owner. Staff said the Company provided little evidence to support the Company's claim that it has ongoing need for this equipment. Staff recommended that the Commission decrease the reported equipment rental expense by $11,474, from $31,474 to $20,000, to match the Company's documented, as opposed to claimed, annual rental expense. Comments at 25, Atch. H.

In its reply, the Company said it has rented heavy equipment for years and routinely repairs service line leaks, repairs and replaces fire hydrants, and upgrades meter barrels. Reply at 9. The Company disputed Staff's claim that the Company only documented $20,000 in 2011 rental equipment expense; the Company said it provided Staff with invoices for the entire $31,474 in 2011 rental equipment expense. *Id.* The Company also said that Staff's recommendation assumes the Company only rented the equipment for 10 months rather than 12. The Company thus asked the Commission to allow an increase of $4,000 ($2,000 per month in rent times two months) for a total equipment rental expense of $24,000 annually. *Id.* at 10.

Commission Decision: Based on our review of the record, we find that the Company's lease of rental equipment from its owner is another related-party transaction. Annualization of the monthly lease yields a reasonable level of rental expense at this time. We find it reasonable to allow the Company to recover $24,000 in equipment rental expense. Allowance of a greater rental dollar amount must be established by need and comparable third-party market analysis. The Company has not adequately supported a higher amount.

2. Rate Base. A water company's "rate base" is its investment in utility plant and the working capital necessary to purify and distribute water, upon which the Company is allowed to earn a fair rate of return. With its Application, Falls Water proposed a $2,545,288.78 rate base. Application at 2, Exh. 1 and 2. The Company and Staff concurred that working capital should be calculated as 1/8 of the allowed operating expense, which we find to be reasonable. *See* Application at 2; Comments at 14. But Staff recommended the Commission adjust rate base components including plant in service (land and land rights, and meters) and accumulated depreciation. The parties' positions on these adjustments are discussed below.

a. *Plant in Service (Land and Land Rights, and Meters).* The Company reported plant in service (PIS) with an adjusted total of $6,606,671.74 as of December 31, 2011. Application Exh. 1. The amount includes, among other items, a $2,213,824.33 balance in PIS account 303-Land & Land Rights. The amount also includes a $1,825,131.62 balance in PIS account 334-Meters. *Id.* Staff recommended decreasing the overall PIS account balance. The parties' positions on land and land rights and meters are as follows.

i. *Land and Land Rights.* Staff recommended that the Commission decrease the land and land rights balance by $92,518 to reflect a Commission-approved adjustment for plant held for future use from Order No. 31022. Comments at 3, 25. The Company ultimately concurred with Staff's recommendation. Reply at 3.

ii. *Meters.* In its Application, the Company asked to increase its rate base by $839,878.35 to recognize the Company's costs to (a) replace 604 manually read meters with new touch-read meters and (b) install MXU radio transmitters on all meters not already so equipped. Application at 2, Exh. 1. If granted, the Company's request would increase the 334-Meter account balance to $1,825,132. *Id.*

In its comments, Staff noted that the Company's $839,878 in meter project costs includes: (a) $126,336 for 604 new touch-read meters and the labor to remove 604 manually read meters; and (b) $713,542 related to buying and installing 3,300 MXUs (in sum, $674,024 for the MXUs, plus $39,518 for financing charges and temporary office labor). Staff Comments, Atch. C. Staff said the $126,336 in touch-read meter investment belongs in rate base because the Commission approved such an investment during the 2009 rate case. Comments at 5. But Staff said the $713,542 in MXU-related investment should be removed from rate base because that investment is not economically justified. Staff Comments at 3, 5, and 25, Atch. A. Staff said the

Company estimates the MXUs will save $8,315 per year in reduced fuel and labor expenses, but that even if the estimated savings are correct it would take the Company 86 years to recover its MXU investment. *Id.* at 6. Staff said the Company's MXU investment is "extremely large" compared to the Company's approved rate base, and that "the Company should have sought Commission approval for the investment before launching the project. Having failed to do so, the Company proceeded at its own peril." *Id.* at 8.

In its reply, the Company said disallowing $713,542 in (about 85% of) meter project costs is confiscatory and prohibits the Company from earning a fair rate of return. The Company said it can accept Staff's recommended, $39,518 disallowance for financing charges and temporary office labor, but that the remaining $674,024 for MXUs should be allowed. The Company reiterated that the MXUs are beneficial because they will reduce labor and fuel expense by allowing the Company to read meters year-round and will help the Company more quickly discover and respond to leaks, thereby saving customers money. The Company notes that other utilities are converting to automated meter reading systems. Reply at 3-6.

b. *Accumulated Depreciation.* In its comments, Staff recommended decreasing accumulated depreciation by $80,739 to account for Staff's recommended, $80,739 adjustment to the Company's claimed, annual depreciation expenses for the meter project. Comments at 3, 25, Atchs. E and I.

In its reply, the Company said that Staff should not have removed $80,739 from accumulated depreciation. The Company pointed out that it did not book depreciation for the meter project during 2011 because that project was still construction work in progress until it was completed in January 2012. The Company's rate base calculation thus restored $80,739 to accumulated depreciation. *Id.* at 6.

Commission Decision on Rate Base: Based on our review of the record and the parties concurrence on land and land rights, the touch-read meter investment, and MXU-related financing charges and temporary office labor, we find that it is reasonable and appropriate to adjust the rate base by disallowing $92,518 of the Company's reported investment in land and land rights, allowing the Company's $126,336 investment in touch-read meters, and disallowing $39,518 of the Company's MXU-related financing charges and temporary office labor.

How to treat the Company's remaining, $674,024 in MXU investment is more problematic. We are deeply troubled that the Company abruptly invested so much money in

MXU transmitters without obtaining prior input from customers, Staff, or the Commission. Had the Company sought such input, it likely would have received direction to prioritize other projects—trunk line improvements, storage and booster tank stations, and replacing old water lines—over the MXUs. While a regulated public utility must spend enough on its system to ensure that its customers receive safe and reliable service, it may not engage in gold-plating at ratepayer expense. We would wholly disallow the Company's MXU investment if the Company were a larger utility.

But the Company is a small water utility, and we are concerned that wholly disallowing the MXU investment could jeopardize the Company's financial integrity and ability to provide safe and reliable service to customers. And while the Company spent far too much too quickly to install its MXUs, we believe the Company's MXUs ultimately will benefit its customers. We thus find it reasonable and appropriate to allow the Company to also include in rate base its $674,024 in MXU investment. That said, we also find it reasonable and appropriate for the Company to reinvest the MXU-related depreciation and the annual savings of $8,315 over 25 years into a special plant reserve fund that the Company may use only to finance infrastructure projects like trunk line improvements, storage tank and booster stations, and replacing old water lines, as referenced in the Company's reply at page 2. The Company must maintain the special plant reserve fund in a separate account, and Staff will routinely audit the deposits and plant investment expenditures to assure compliance with this Commission directive. A final word of caution to the Company about its upcoming projects: With this Order, we are not passing on the prudency of any of the Company's potential infrastructure projects, and *we strongly encourage the Company to consult with Commission Staff before it begins any such projects*. To the extent any investments from this special plant reserve account are approved by the Commission, they will be allowed in rate base and depreciated like any other prudent plant investment.

Lastly, based on our review of the record, we find that the Company did not book depreciation on the new meters in 2011. For ratemaking purposes, the revenue requirement includes the meters in rate base and a full year of depreciation expense. We thus find that accumulated depreciation is now consistent with the inclusion of depreciation expense in rates.

Based on the above discussion, we approve a total rate base of $2,414,927.

3. Rate of Return. The Company's proposed capital structure and overall rate of return/weighted cost of capital is set forth in Application Exhibit 3. In sum, the Company proposed a 3.25% cost of debt, a 12% return on equity (ROE), and a 7.75% overall rate of return/weighted cost of capital. Application at 4, Exh. 3.

In its comments, Staff concurred with the Company's proposed capital structure and cost of debt at 3.25%. Comments at 2. But Staff recommended the Commission decrease the ROE to 11.00% and the overall rate of return to 7.23% to reflect that market achieved and allowable returns are lower now than when the last rate case occurred. *Id.* at 2, 14-15, and 26. Staff also considered a lesser, 10% ROE because the Company's equity ratio exceeds 50% and it lacks a significant required capital budget for the near future; but Staff ultimately determined that 11% was appropriate due to the increased regulatory risk arising from Staff's large, recommended MXU adjustment. *Id.*

In its reply, the Company disagreed with the Staff's recommendation to decrease the ROE and overall rate of return. The Company said it needs a higher ROE to attract capital for future projects and because it is more susceptible to the adverse impact of risks and market forces than is a larger company. Reply at 2.[7] Notwithstanding these arguments, the Company ultimately said it could accept Staff's recommended lower ROE if the Commission would allow the Company to recover its MXU investment and associated depreciation expenses. *Id.*

Commission Decision: Based on the record and the parties' agreement, we find that the Company's proposed capital structure and 3.25% cost of debt is reasonable and appropriate. With respect to the ROE and overall rate of return, we note that the record references potential ROE's of 12% (Company), 11% (Staff, to recognize risk associated with disallowing MXUs), and 10% (Staff, based on the Company's 50%+ equity ratio and no significant future capital budget). After carefully reviewing the record and the parties' arguments, we find an ROE of 10.5% and an overall rate of return of 6.97% is fair to both the Company's investors and its

[7] When discussing its risks, the Company said it is regulated by "agencies whose policies tend to swing with current political and economic conditions." The Commission reassures the Company that the Commission has consistently designed procedures to help small company's remain viable while providing safe and reliable service. The Company also observed that its investors make a long-term commitment and expect an average return over many economic and political cycles. The Company then blithely asked: "When the economy was doing very well and the stock market was producing 25% to 30% returns did the PUC raise the ROE to compete with the economic conditions?" *Id.* The Company misunderstands the Commission's role and the Company's responsibilities. Simply put, if the Company believed it was entitled to a higher ROE, then it should have asked the Commission to approve a higher ROE. The Commission expects a public utility to understand its financial needs. If the Company believed it had such needs, then it should have asked the Commission to address them through a rate proceeding.

customers and will enable the Company to successfully operate and attract capital. In making this finding, we note that while we are not allowing the Company the full ROE it requested, we are allowing a return on the Company's MXU investment and are accepting the Company's arguments about depreciable life and salvage value.

C. Revenue Requirement

In its Application, the Company proposed increasing its revenue requirement by $295,059.75 (26.52%), from $1,112,611.36 (2011 adjusted revenue) to $1,407,671 (requested revenue requirement). *See* Application at 4, Exh. 4. The Company calculated the increase using a $2,545,288 rate base, a 12% return on equity and an overall 7.75% rate of return, $933,351 in ordinary expenses, plus $215,195 in net other expenses.

In light of the adjustments proposed in its comments, Staff recommended a lesser, overall revenue requirement of $1,169,054, which represents a $15,832 (1.4%) revenue increase. Staff Comments at 14-15, 25.

The Company's reply then provided information that ultimately led Staff to re-adjust depreciation expenses in the Company's favor. Staff's re-adjustment increased Staff's original recommended revenue requirement from $1,169,054 to $1,171,179. Surreply at 2.

Commission Decision: Based on our review of the record and our above findings, we establish a new revenue requirement of $1,257,158 and find it is fair, just, reasonable and sufficient to enable the Company to recover its operating expenses and the rate of return on rate base as allowed in this Order.

II. RATE DESIGN

In its Application, the Company proposed to achieve its requested revenue requirement by increasing its metered rates and decreasing the included maximum gallons allowed as summarized on page 2 of this Order.

In its comments, Staff recommended the gallons allowed to customers and the commodity charge remain unchanged, and any increase in rates be uniformly spread on the customer charge. Comments at 16. Staff said it normally supports decreasing the volume allowance for a customer charge to the average customer's monthly winter usage, but it does not do so here because: (a) the Staff-recommended revenue increase is small compared to the volume allowance reduction, and the Company's proposal to decrease the volume allowance but not the customer charge would increase customer bills above Staff's proposed revenue requirement percentage increase; and (b) Staff cannot analyze the actual revenue impact of the proposed volume allowance change without the Company's water consumption data. *Id.* at 17. Staff thus said the Commission should keep the Company's current volume allowance for various meter sizes. *Id.* Staff concurred with the Company's proposal to base rate design on customer distribution by meter class as follows:

Meter Class	No. of Customers	% Distribution
5/8 and ¾-inch	3,679	95.8%
1-inch	109	2.8%
1 ½-inch	17	0.4%
2-inch	33	0.9%
4-inch	2	0.1%
Total	3,840	100.0%

Id. at 18.

Staff said the Company estimated its variable (commodity) revenue using 2011 monthly excess-water usage data, and that the Company proposed to apply a commodity rate of $0.67/1,000 gallons to the monthly excess-water usage for various customer classes. *Id.* The Company estimated 734,085,000 gallons in total annual excess water usage for all customer classes (having already subtracted the volume allowance for each customer class). *Id.* However, Staff said the Company's estimated excess usage no longer applies to the extent the Commission accepts Staff's recommendation to maintain current volume allowances. *Id.* Staff said commodity sale revenue depends on commodity rate and the quantity of water billed at that rate. Staff's rate calculations assumed an excess usage volume based on: (1) the estimated excess usage volume rate per customer from the Company's last rate case (Case No. FLS-W-09-01, Order No. 31022); and (2) a 3,840 total customers. Staff said the Commission should calculate commodity revenue based on an annual excess usage of 639,602,000 gallons.[8] *Id.* To maintain Company revenue stability, Staff recommended increasing the customer charge and leaving the commodity rate at its current level. *Id.* at 20. Staff proposed the following rate design:

[8] Adjusted total annual excess volume = 605,955 (Order No. 31022)/3,638 x 3,840 = 639,602,000 gallons.

BASIC CUSTOMER CHARGES

Service Meter Size	Vol. Allowance in Gallons	Minimum Charge
5/8 and ¾- inch	12,000	$16.44
1-inch	17,000	$23.02
1 1/2 inch	22,000	$29.59
2 inch	28,000	$37.81
4-inch	49,000	$67.40

COMMODITY CHARGES

Commodity Charges for all Meter Sizes ($/1,000 gallons)	$0.611

Staff's proposed rate design leaves the commodity charge as is while increasing the customer charge from the current, $16.10/month rate to $16.44/month (a 2.1% increase for a typical customer with a 3/4-inch meter). *Id.* Staff's proposal would increase the average, residential customer's monthly bill to $21.10/month (a $0.34 or 1.6% increase over current rates). *Id.*

In its reply, the Company disagreed with Staff's recommended rate design and commodity rate charge, but agreed to keep the volume allowance at 12,000 gallons for ¾-inch and smaller meters. Reply at 6. The Company also disagreed with Staff's recommended annual excess usage volume. The Company proposed an excess usage volume of 573,038,000 gallons based on 2011 data and the number of new customers in the Company's service territory. Reply at 6-9.

In its surreply, Staff said the Company had not provided the 2011 customer-usage data to Staff when Staff was preparing its comments. Based on the new data, Staff conditionally accepted the Company's proposed, excess usage volume. Surreply at 2. Staff then normalized water usage over several years as follows:

Customer Type or Class	Company-Prop. Excess Usage (2011 data-gals)*	Percent of Total Excess Usage	Ratio of Average Annual Usage to 2011	Normalized Total Annual Excess Usage
Residential	522,959,000	91.26%	1.05245	550,387,746
Multi-Family	19,296,000	5.37%	0.95724	18,470,918
Commercial	30,406,000	3.37%	1.14916	35,374,471
Total	573,038,000	100.0%	1.05444	604,233,135

**Calculated excess usage over present volume allowance for all meter sizes.*

Surreply at 3. In sum, Staff said the Commission should leave the commodity rates unchanged and recalculate the customer charges for various meter sizes based on the final, Commission-approved revenue requirement and the excess volume amounts discussed above. Surreply at 4.[9]

Commission Decision: Based on our review of the record, we find that customer charges should be increased uniformly by the percentage increase in revenue requirement of 11.09% and rounded to the nearest $0.25. The commodity rate should be increased to achieve the remainder of the new revenue requirement based on a normalized, total annual excess volume of 604,233 gallons. We find the rate design set forth in the Attachments to this Order to be a fair, just, reasonable and sufficient way for the Company to recover its new revenue requirement.

III. OTHER ISSUES

A. Amending Company's CPCN

In its comments, Staff recommended the Company apply to amend its CPCN No. 236 after this rate case concludes to reflect that the Company is servicing subdivisions outside its currently certificated area. Staff Comments at 21, 25. The Company concurred with Staff's recommendation. Reply at 10.

Commission Decision: Based on our review of the record and the party's agreement on this issue, we find it reasonable to require the Company to amend its CPCN as set forth above.

B. Year-Round Meter Reading

In its Application, the Company proposed to read meters year-round. Application at 5. The Company presently reads single-family residential meters from April through October but not during the winter due to difficult meter access. But the newly installed meter project meters will enable the Company to read meters year-round. *Id.* The Company said year-round meter reading benefits customers and conserves water because plumbing leaks will be detected sooner. Further, customers will be able to pay for water use above the minimum as overages are

[9] Another rate design issue involves the Company's proposal to include a new Schedule No. 3 for Private Fire Sprinkler and Service. Application at 6. The Company, however, did not provide the proposed Schedule No. 3, and the Company subsequently withdrew its proposal. Comments at 21. Staff did not oppose the Company's decision to withdraw the proposal, but it recommended the Company conduct further investigation into how many customers have private sprinklers or firefighting lines and then submit a revised proposal to the Commission in the Company's next rate case. *Id.* The Company agreed to investigate the issue and to propose a separate tariff for this service. Reply at 11.

incurred; customers presently do not pay for excess water use that occurred from November through March until the Company bills them in April. *Id.*

In its comments, Staff said the Company is now fully converted to an automated meter reading (AMR) system, is ready to read meters year-round, and has explained how year-round reading benefits customers. Staff thus recommended the Commission approve the monthly meter-reading request. Comments at 22, 25.

The Company's reply initially said the Company "does not wish to read meters year-round if it must bear the costs of the [AMR] equipment on its own." Reply at 6. That said, the Company acknowledged that year-round meter reading benefits water resource management, conservation planning, and water right planning. Reply at 10. The Company thus concluded: "while disagreeing with the Staff assessment of the benefit of our project for our customers, [the Company] is in agreement that year-round meter reading is a positive step towards meeting water resource management goals." *Id.*

Commission Decision: Based on our review of the record and the party's agreement on this issue, we find it reasonable to authorize and direct the Company to begin reading meters year-round.

C. Unauthorized Charges to Customers

In its comments, Staff said that the Company has been making the following four types of unauthorized charges relating to building new facilities to serve new customers: (1) a charge for improvement to physical plant which varies depending upon whether the water provided will be used for irrigation; (2) two different charges for the cost of water rights depending upon whether the water provided will be for in-house use and/or irrigation; (3) a miscellaneous development fee to cover engineering costs, and (4) a charge to install a service line underneath a street to the customer's property. Comments at 22. Staff said the first three charges contradict the Uniform Main Extension Rule within the Company's approved tariff, and that the Commission has not approved such charges for any other small water company. *Id.* at 22-23. But Staff also noted the Commission has previously approved the fourth charge for other companies and allowed those companies to charge customers for installing a service line under a roadway to provide a customer connection. *Id.* at 23, *citing* Case Nos. DIA-W-07-01, BCS-W-09-02, and MUR-W-10-01. Staff thus recommended the Commission authorize the Company to modify its tariff to include the following Commission-approved language:

> When the installation of a new service line requires the Company to bore a line under a road, all additional costs will be charged to the customer on a time and materials basis. The new customer may, at their option, hire a Falls Water Company approved independent contractor to perform the road bore and connection. The Company will require such contractor to show proof of bonding, licensing and insurance and have at least five (5) years of experience at hot tapping water lines. Falls Water Company will inspect and approve all the work being performed to insure compliance with the Company's installation requirements.

Staff also recommended the Company refund to customers any unauthorized charges collected from them over the past three years. *Id.* The Company agreed with the Staff's recommendations. Reply at 11.

Commission Decision: Based on our review of the record and the party's agreement on this issue, we find it reasonable to authorize the Company to modify its tariff to include the Commission-approved language referenced above. We also find that the Company's unauthorized charges were excessive. The Company must, therefore, refund to its customers the four types of unauthorized charges referenced above, to the extent collected within the past three years, with interest from the date of collection. *See Idaho Code* §§ 61-641 and 61-642; and Rules 203-204 of the Utility Customer Relations Rules (UCRR). We find interest at 1% per annum to be reasonable and appropriate in this situation. *Reference* UCRR 106. Within the next 60 days, the Company shall prepare a corrected billing indicating the refund due to each customer who was charged and issue a credit on the customer's next bill. The Company shall credit any remaining credit balance against future bills unless the customer, after notice from the utility, requests a refund. *See* UCRR 204.

D. Customer Notice and Press Releases

In its comments, Staff said the Company's customer notice and press release detailed the Company's proposed percentage increase for various connection sizes but did not explain how the Company determined the percentage increase for each customer class. Staff said the Company later explained its methods to customers during the workshop. But Staff recommended the Company's future customer notices comply with Rule 25 of the Commission's Rules of Procedure, (IDAPA 31.01.01), which states: "the notice shall give the proposed overall percentage change from current rates as well as the proposed percentage increase in revenue for each major customer class." Comments at 24, 26. The Company agreed with Staff's recommendation. Reply at 11.

Commission Decision: Based on our review of the record and the party's agreement on this issue, we find it reasonable to direct the Company to ensure that its future customer notices comply with the Commission's Rules, as set forth above.

E. Xpress Bill Pay

In response to customer requests, the Company contracted with Xpress Bill Pay to let customers pay their bills online. The Company said that when other utilities provide such a service, their vendors typically charge the customer a convenience fee. The Company opted to pay for the cost of the program. The Company said the on-line bill pay program costs are less than the Company's prior merchant pay system, and that numerous customers have signed up. Staff believes that the volume of customer participation to date indicates the appropriateness of the program, and Staff supports the Company's decision. Comments at 25.

Commission Decision: Based on our review of the record, we believe it is appropriate to approve the Company's implementation of Xpress Bill Pay. We commend the Company for utilizing its on-line bill pay option to save costs while increasing customer convenience.

ULTIMATE FINDINGS OF FACT AND CONCLUSIONS OF LAW

Falls Water is a water corporation. The Commission has jurisdiction and authority over Falls Water and the issues raised in this case, pursuant to Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000, *et seq.* Based on our review of the record, we find that Falls Water's existing rates, charges, and practices are unreasonable to the extent described in the body of this Order, and that the rates do not afford sufficient revenue to the Company. *See Idaho Code* §§ 61-501 and 502. We also find it fair, just, and reasonable for the Company to changes its rates, charges, and practices as described in this Order. Accordingly, we approve a 10.5% ROE and an overall rate of return of 6.97% on a total rate base of $2,414,927, and we authorize the Company to increase its annual revenues by $125,546 to satisfy a total revenue requirement of $1,257,158. *See* the Attachments 1 and 2 to this Order, further detailing this decision.

ORDER

IT IS HEREBY ORDERED that Falls Water shall have an annual revenue requirement of $1,257,158, with expenses, rate base, rate of return, capital structure, and rate design as detailed in the body of this Order and its Attachments. The Company shall submit tariffs in compliance with the rates and charges identified in this Order no later than fourteen (14) days from the service date of this Order. The rates and charges authorized by this Order shall become effective for service rendered on and after October 16, 2012.

IT IS FURTHER ORDERED the Company shall maintain repair and replacement logs for its meters to better enable the Company and Commission to assess the meters' useful lives;

IT IS FURTHER ORDERED that the Company shall apply to amend its CPCN as described in this Order;

IT IS FURTHER ORDERED that the Company shall read its customer meters year-round;

IT IS FURTHER ORDERED that the Company shall refund the unauthorized charges collected from customers as set forth in the body of this Order. The Company may file a modified tariff with the language quoted in this Order that will enable the Company to charge customers when it must install a service line under a roadway to provide a customer connection;

IT IS FURTHER ORDERED that the Company shall ensure that its future customer notices comply with RP 25, with such notices giving "the proposed overall percentage change from current rates as well as the proposed percentage increase in revenue for each major customer class."

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 12th day of October 2012.

PAUL KJELLANDER, PRESIDENT

MACK A. REDFORD, COMMISSIONER

MARSHA H. SMITH, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

O:FLS-W-12-01_kk5

Falls Water Company
Summary of Commission Decision

Plant In Service		$ 6,474,635
Accumulated Depreciation		(1,589,467)
CIAC		(2,588,586)
Working Capital 1/8*		118,345
Total Rate Base		$ 2,414,927

Expenses Commission Decision		
Electrical Power	131,871	
Chemicals	6,625	
Rental of Property	41,995	
Rental of Equipment	24,000	
Depreciation	103,919	
Total Expenses		$ 1,058,179

Capital Structure and Return

	Percent	Cost	Weighted
Long-Term Debt	48.63%	3.25%	1.58%
Equity	51.37%	10.50%	5.39%
Total	100.00%		6.97%

Revenue Requirement

Rate Base	2,414,927	
Required Rate of Return	6.97%	
Return		168,320
Gross-up		30,659
Total Expenses		1,058,179
Total Revenue Requirement		$ **1,257,158**

ATTACHMENT 1
CASE NO. FLS-W-12-01
ORDER NO. 32663

Falls Water Company Case No. FLS-W-12-01
Commission-Approved Rate Design (By Service Meter Size)

Commission-Approved Revenue Req.	**$1,257,158**
Total Number of Customers	**3,840**

MINIMUM CUSTOMER (BASE) CHARGES

Service Meter Size	Number of Meters	Minimum Volume-Gals	Minimum Charge	Total An. Rev. from Min. Charge
5/8 and 3/4 - inch	3,679	12,000	$17.75	$783,627
1-inch	109	17,000	$25.00	$32,700
1 1/2 - inch	17	22,000	$32.25	$6,579
2 - inch	33	28,000	$41.00	$16,236
4 - inch	2	49,000	$73.25	$1,758
Total	**3,840**			**$840,900**

COMMODITY CHARGES

Total Annual Excess Volume for all meter sizes (x 1,000 gals)	604,233
Commodity charges for all meter sizes ($/1,000 gals)	$0.689
Total Commodity Revenue	**$416,317**

Total Revenue (base and commodity charges)	**$1,257,217**
Revenue collected over (under) Revenue Requirement	**$59**

Various Charges as a % of Gross Revenue

Minimum Charge	**67%**
Commodity Charge	**33%**

**Normalized annual volume of excess usage.*

ATTACHMENT 2
CASE NO. FLS-W-12-01
ORDER NO. 32663