Q.Please state your name and business address?

A.My name is Robert E. Smith.  My business address is 472 West Washington Street, Boise, Idaho.

Q.By whom are you employed and in what capacity?

A.I am employed by the Idaho Public Utilities Commission.  My title is Senior Auditor.

Q.Please describe your educational background and professional experience.

A.I received my BBA degree majoring in Accounting from Boise State University in 1972.  Following graduation I was employed in the construction industry as Accountant/Office Manager until April 1975 when I accepted employment at the Idaho Public Utilities Commission.  During the course of my employment at the Public Utilities Commission, I have attended numerous training schools, programs and seminars in the field of regulation.

Q.Have you previously appeared as a witness in regulatory proceedings?

A.Yes, many times.

Q.What subjects have you addressed in those previous appearances?

A.I have presented testimony and sponsored exhibits dealing with rate base, operating results, cost of capital, revenue requirement, rate design, corporate cost allocations, corporate affiliated transactions, jurisdictional cost allocations and class cost-of-service allocations.  These appearances have included cases dealing with electric, gas, water, and telephone companies.

Q.What is the purpose of your testimony in this case?

A.I will present the Commission Staff’s (Staff) recommendations regarding rate base and revenue requirement for both the Sagle Valley Estates (Sagle) water system and the Algoma Addition (Algoma) water system.  I will also discuss some of the history of these two systems and several applicable policy positions that have been established by the Idaho Public Utilities Commission (IPUC).

Q.Does Staff believe that the Sagle and Algoma water systems should be regulated by the Idaho Public Utilities Commission (Commission)?

A.Yes.  Staff's investigation confirms that the systems are being operated as a public water utility as defined in Idaho Code, Title 61.  (See Commission Order No. 26074 dated June 29, 1995.)

Q.Do you recommend that the Commission issue a Certificate of Public Convenience and Necessity for these water systems?

A.Yes.  However, as I will explain later, Staff is unsure in what name[s] certificates should be issued.  We do believe that a separate certificate should be issued for each system.

Q.Are these two systems interconnected?

A.No.  The Sagle system is located approximately one mile west of U.S. Highway 95 in the Northeast Quarter of Section 16, Township 56 North, Range 2 West of the Boise Meridian.  The Algoma system is located on the East side of this highway in the Southeast Quarter of Section 16, Township 56 North, Range 2 West of the Boise Meridian.

Q.Is it the Staff’s position that the two systems should be operated and maintained separate from one another?

A.Yes.  Staff is unsure of the name[s] of the rightful owner[s] of each system.  Several individuals and corporations appear to have potential interest in both of these systems.  Until the ownership question is ultimately resolved, Staff believes the systems should be treated independently by the Commission.  When the ownership question is ultimately resolved, and if the ownership of both systems is in common, the Commission and the ultimate owner[s] may wish to consider combining the two systems into a single operating company.

Q.Are you aware of any pending sale of either of these systems?

A.No.  The residents of the Sagle system have formed a water district and have expressed an interest in purchasing that system, but I am not aware that any offers have either been made or accepted.

Q.What is the Staff’s position regarding the conversion of a regulated water system to a water district?

A.Assuming technical, managerial and financial ability to provide reliable and adequate water service, Staff fully supports and encourages the formation of water districts, homeowner associations or cooperatives to own and operate small water systems.

Q.What is it about these two water systems that led to your comment earlier that Staff is unsure of the name(s) in which certificates should be issued?

A.Both of these systems have a history that goes back to the early 1980's.  The two systems were developed by unaffiliated parties.  Each of the systems has been sold at least twice.  Historical records of the two systems and specific documentation of the various sales transactions are not available.  At the time the Staff first became aware of these systems, ownership appeared to be in common through a corporation known as Goldan.  However, as the Staff continued its investigation in this case, it became evident that the principals in Goldan were in the process of dissolving their business relationship.  At this time, the final resolution to that dissolution is not complete and ownership of the two systems is unknown to the Staff.

Since January of 1996 billings for service on both systems have been sent by Mountain Pacific Land Company which is owned by one or more of the principals in Goldan.

Q.So, in what names do you believe the certificates should be issued?

A.Staff believes the certificates should be issued in the name of Mountain Pacific Land Company.  The certificates would become property to be dealt with in arbitration among the principals in ownership, or by the courts if necessary, along with the physical property of the water systems.

Q.What is the Staff’s recommendation regarding rates for these two systems.

A.Mr. Don Oliason of the Staff will discuss the specifics of rate design in his testimony.  Staff analysis of the revenue requirement on the Sagle system indicates that the total water revenue currently being collected from the customers should be reduced by approximately 44%.  The water revenue from the customers on the Algoma system should also be reduced by approximately 44%.

Q.Are you sponsoring exhibits in this case?

A.Yes.  I am sponsoring Exhibit Nos. 101 through 104 relating to the Sagle system, Exhibit Nos. 105 through 108 relating to the Algoma system, Exhibit No. 109 relating to both systems and Exhibit No. 110 which is the Staff’s final report regarding our analysis in this case.  The report (Exhibit No. 110) is the basis of my testimony.

Q.Was the report (Exhibit No. 110) provided to the principals in ownership of the two water systems for their review?

A.Yes, the report was mailed to them on January 19, 1996 with instructions to mail any comments to my attention by February 5, 1996.  It was also provided to several interested customers of the systems.

Q.Did you receive any comments?

A.No.  I did receive a phone call on   February 5, 1996 from an attorney representing Mr. Callihan (one of the principals) asking for an extension of time to reply.  I agreed and asked to have their comments on the report back to me by February 25, 1996.

Q.Did you receive any comments?

A.No.  Mr. Richardson, Esq., representing Mr. Callihan, did come to the IPUC offices and review my files but no comments were filed.

Q.Please describe Exhibit No. 101.

A.This exhibit refers only to the Sagle system.  In 1994, Welch Engineering in Sandpoint was engaged to prepare an engineering estimate of the value of the Sagle water and sewer systems.  This exhibit is a copy of that estimate.  The estimate represents a replacement cost for the physical assets stated in 1994 dollars which then are depreciated for their age.  The depreciated present value determined for the water system assets by Welch is $24,577.  The land value associated with the water system shown at the top of this exhibit of $50,000 was provided to Welch by the owners.

Q.Do you believe this valuation is correct for determining water rates on the Sagle system?

A.No.  This Commission has never used current replacement cost as the basis for rate determination.  The Commission always uses original cost when first devoted to public use for that purpose.

Q.Were you able to determine the actual original cost of installing the Sagle water system?

A.No.  There are no records of those costs available.

Q.So, how did you determine a reasonable valuation for this system?

A.Exhibit No. 102 shows that calculation.  I used the Welch estimate of un-depreciated replacement cost in 1994 dollars shown in Column (E) of Exhibit    No. 102 as the basis of my calculation.  I discounted this 1994 replacement cost back to the year of original installation to develop the discounted value shown in Column (F).  The calculation of the discount rate is shown on Exhibit No. 109.  This discounted value represents the original undepreciated cost in the year of installation.  Column (I) shows the 1995 depreciated value of the original cost which the Commission could include in rate base for the Sagle system if it chose to do so.

Q.Does this valuation include any allowance for the value of the land dedicated for the well?

A.No.  On Exhibit No. 104 I have added a subjective value of $5,000 for the land, which I will discuss later.

Q.Have you reviewed the operating costs for the Sagle system?

A.Yes.  Exhibit No. 103 presents a statement of operating results composed of actual and estimated data for the year 1995.

Q.Why are some of the data estimated?

A.Prior to 1995 no separate financial data was maintained for the Sagle system.  It was commingled with several other business activities including the Algoma system.  Beginning in 1995, a separate accounting system was established.  This new system is still commingled with the Algoma system and there is no separation of the water system costs from sewer costs.

At the time I performed my review, only nine months of data were available.  I separated and assigned the financial data between the Sagle and Algoma systems and then further separated the data between the water and sewer services.  Column (B) of Exhibit No. 103 shows the actual recorded operations separated and assigned to the Sagle water and sewer systems.  Columns (C) and (D) further separate these results between the two Sagle services.

In Column (E) I have annualized these results for the water service and estimated several normal operating expenses that had not been recorded during the nine month period.  The normal expenses that had not been recorded are identified by the zeros shown in Column (B).

Q.Does this exhibit portray the Staff’s recommendation in this case?

A.Yes.  The Staff position in this case is that water rates for the Sagle system should be established to recover reasonable operating costs only.  Those reasonable operating costs should include compensation for the labor required to operate, maintain and manage the system.  Column (E) is Staff’s recommendation in this case for the level of reasonable operating costs that should be recovered through rates for water service.  As shown on line 17, the average monthly revenue collected from customers on this system should be $14.63, which is $11.37 less than the $26 per month flat rate currently being charged.

Q.The Staff’s position does not then include any return on the investment (rate base) made in the physical assets of the water system?

A.That is correct.  Staff takes the position that the investment in the physical assets has been recovered through the original sale of lots within the subdivision by the original developer.  The current owners who acquired the system together with numerous other pieces of real estate have no basis in the water system.  It is our position that the value of the real estate acquired in this most recent purchase represents the full value of the purchase price.  Staff has made several requests for the details of the purchase price but has not received them.  Staff Exhibit No. 110,   pages 4-7 presents additional discussion of the various sales transactions that have occurred affecting this water system.

Q.If the Commission were to determine that indeed there is an investment in rate base, and the owners should receive a return on that investment, what rate base would you recommend?

A.Exhibit No. 104 presents that calculation.  The rate base of $17,307 shown here on line 3 includes the Staff valuation of plant in service discussed on Exhibit No. 102, plus an allowance of $5,000 for the well lot.

Q.What is the basis of the $5,000 valuation you have allowed for the well lot?

A.Staff's analysis of the most recent purchase transaction that transferred this system to the current owner[s] indicated that the highest estimated sales price would produce an average cost of $5,714.29 for each lot acquired.  The well lot is a “flag” lot located behind two adjacent lots with access between those lots.  This configuration makes the lot less desirable than a lot with street frontage.  Details of the properties included in this sale are shown on pages 4 and 5 of Exhibit

No. 110.

Q.What do you mean when you make reference to the highest estimated sales price?

A.Staff requested information on this most recent sales transaction and received a copy of the warranty deed that describes all of the properties being transferred.  Despite numerous requests, we did not receive any documentation regarding the sales price.  Orally, Staff was quoted two different sales prices.  The first and lower number of $100,000 was quoted to my predecessor on this case, Mr. Jack Taylor, in late 1994.  In late 1995, I was quoted a sales price of $200,000.

Q.What would be the effect on water service rates if the Commission were to adopt a rate base of $17,307?

A.Using a return of 12%, which is consistent with returns recently granted other small water systems, average monthly water service rates should be reduced by $1.11 as shown on line 12 of this exhibit.

Q.Exhibit Nos. 105 through 108 appear to very similar to the previous four but indicate they represent your analysis of the Algoma Addition.  Was your analysis of this system performed in a similar manner?

A.Yes.  These exhibits were prepared for the Algoma system in an identical manner as Exhibit Nos. 101 through 104 for the Sagle system.

Q.Are there any substantive differences between your analysis of the Sagle system and the Algoma system?

A.Only in terms of the manner in which the systems were acquired by the current owner[s].

Q.What is that difference?

A.The Algoma system was acquired through a direct purchase of the water and sewer systems.  No other properties were involved in this purchase.  The owner[s] purchased the systems for $95,000.  They paid $10,000 down on the purchase plus $260.66 in closing costs and signed a note for the remaining $85,000.

Q.Should the Commission recognize this purchase price as a fair valuation for inclusion in rate base and allow a return to be earned on the investment through water rates?

A.No.  As discussed on pages 11 and 12 of Exhibit No. 110, the Commission should consider all of this purchase price an acquisition adjustment.  The purchase was made from the final developer of the subdivision who would have recovered the cost of the systems through the sale of lots as presumed by the Commission's Rule 103.  The Commission normally does not allow a return on acquisition adjustments unless there is clear evidence that the customers on the system will realize some compensating benefit.  In this case, the sale simply transferred ownership with no visible benefit to the customers.

Q.With this rather significant difference would your discussion of the revenue requirement on the Algoma system be the same as the discussion of the Sagle system?

A.Yes.  The revenue requirement should be based upon recovery of operating costs, including reasonable compensation for labor to operate, maintain and manage the system.

Q.Does Exhibit No. 107 represent the Staff’s recommendations for water rates on the Algoma system?

A.Yes.  Staff’s analysis indicates average monthly residential rates should be reduced by $11.48 from the current $26 per month to $14.52.  The average monthly commercial rate should be reduced by $18.37 from the current $41.60 to $23.23.

Q.If the Commission were to decide to allow a return on the owner[s] investment in this system how should that investment be valued?

A.Staff would recommend the use of the discounted system valuation shown on Exhibit No. 106 of $44,568.18 plus a reasonable allowance for the value of the well lot.  The remainder of the purchase price of $95,000 should be considered to be the cost of the sewer system and an acquisition adjustment not includable in the rate base valuation for the water system.

Q.What effect would this approach have on the average monthly rates of the customers?

A.Exhibit No. 108 shows that calculation assuming a $5,000 value for the well lot.  Average monthly residential rates would have to be increased from the current $26 per month to $45.18 and average monthly commercial rates would have to be increased from the current $41.60 to $72.29.

Q.Does that conclude your testimony in this proceeding?

A.Yes, it does.