

DONOVAN E. WALKER
DEPUTY ATTORNEY GENERAL
IDAHO PUBLIC UTILITIES COMMISSION
PO BOX 83720
BOISE, IDAHO 83720-0074
(208) 334-0357
IDAHO BAR NO. 5921

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IDAHO PUBLIC UTILITIES COMMISSION

Street Address for Express Mail:
472 W. WASHINGTON
BOISE, IDAHO 83702-5983

Attorney for the Commission Staff

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)
KOOTENAI HEIGHTS WATER SYSTEM, INC.) **CASE NO. KHW-W-05-1**
FOR A CERTIFICATE OF PUBLIC)
CONVENIENCE AND NECESSITY)
)
) **COMMENTS OF THE**
) **COMMISSION STAFF**
)

The Staff of the Idaho Public Utilities Commission, by and through its Attorney of Record, Donovan E. Walker, Deputy Attorney General, in response to the Second Notice of Application and Second Notice of Modified Procedure on January 27, 2006, Order No. 29960, submits the following comments.

BACKGROUND

On August 22, 2005, Kootenai Heights Water System, Inc. (Kootenai Heights; Company) filed an Application for a Certificate of Public Convenience and Necessity (CPCN) with the Idaho Public Utilities Commission (Commission). On September 30, 2005, the Commission issued an initial Notice of Application and Modified Procedure establishing a deadline for written comments of November 10, 2005. On November 1, 2005, the parties executed a Stipulation asking the Commission to suspend the written comment deadline. The Commission suspended the comment deadline and directed the parties to report the status of this matter to the Commission within 60

days. Order No. 29909. On January 20, 2006, Staff reported that the Company wishes to proceed with its original Application. The Commission issued a Second Notice of Application and Modified Procedure setting the comment deadline of March 9, 2006.

STAFF ANALYSIS

Kootenai Heights Water System consists of eleven (11) residential lots and one lot used for a well site and pump house. The adjacent area is served by the City of Kootenai, Idaho, who currently has a moratorium on allowing water users located outside its established water area boundaries from connecting to the city's water system. There is no other domestic water supplier close enough to financially justify providing this area's water needs. The City of Sandpoint, for example, would have to cross part of the City of Kootenai to serve the area.

Floyd and Mickie McGee (McGees) are the developer of this property; and are the officers and shareholders of the Applicant. The McGees were the owners of all the property included in the proposed service area and were the grantors transferring the ownership of Lot 10 (the well Lot) to the Applicant. Development began in 2004 and a hook-up fee of \$5,000 has been received from each of the 11 lots for a total amount of \$55,000.

The system consists of one 4 inch, 5 HP well pump with an 8 inch casing pumping from a depth of approximately 200 feet. There are three 100-gallon hydro-pneumatic tanks to maintain pressure in the system. All equipment is located on the well lot. There is no other water storage in this system.

The Company has indicated in the documentation filed with the Application that it incurred cost as follows to develop the water system:

Well Installation	\$ 11,370
Distribution Lines	\$ 8,915
Well House	\$ 6,000
Pump, Pressure, Electrical	\$ 16,910
Engineering	\$ 1,800
Attorney Fees	<u>\$ 3,500</u>
Total	\$ 48,495

Additionally, the Company is claiming the current fair market value of the well lot at \$40,000.

Kootenai Heights has a Water Service Agreement it proposes as the basis for rates and policies concerning the operation of the water company. The water service agreement provides for

the charging of a water usage fee in the amount of forty dollars (\$40.00) per month for 10,000 gallons, with the excess gallons used over 10,000 per month being at the rate of \$4.00 per thousand gallons.

The McGees own additional property adjacent to the proposed service area property, and plan to develop this property in the future. If this property were developed, the McGees would consider combining the water systems of the anticipated development with the water system under consideration in this Application.

Technical Review

The well capacity determined from well records and pump data is sufficient to serve the present customer base. The three (3) pneumatic pressure/storage tanks are also adequate. The Company has notified both the Panhandle Health District and DEQ that it plans to expand the system to serve an additional 48 customers. Both DEQ and the Health District have advised the Company that the expansion will require further review and approval.

In a letter dated January 6, 2005 the DEQ approved the existing system contingent upon full compliance by the Company with five (5) items delineated in the approval letter. The responsible engineer at DEQ has advised Staff that all but one of those requirements has been satisfied and that the remaining requirement needs several more months of water testing before it can be resolved.

Also, the system was reviewed and inspected on February 10, 2005 by the Health District. The Health District notified the Company's certified operator, Kirk Marine, of the results of that inspection in a letter dated February 27, 2005. That letter notes that the system is mostly in compliance with IDAPA 58.01.08 with nine (9) required improvements and two (2) suggested improvements noted.

The Company has hired a certified operator to manage the water company and appears to have the financial ability to maintain adequate service. Therefore, Staff recommends that the Company be granted a CPCN and work to comply with the requirements of the DEQ and the Health District.

Financial Review

Based on a review of the financial records and the historical relationship between the developer and the water company, Staff believes the Company would not be entitled to recognize any rate base in the establishment of rates for two reasons. First, Commission Rule 103 for small

water companies (IDAPA 31.36.01103) establishes a presumption that capital invested in the water system by the developer is considered contributed capital and is excluded from rate base. Rule 103 states:

In issuing certificates for a small water company or in setting rates for a small water company, it will be presumed that the capital investment in plant associated with the system is contributed capital, i.e., that this capital investment will be excluded from rate base.

Second, the Company has received contributions in the nature of hook-up charges in the amount of \$55,000. This contribution is an offset to the cost of the system. (\$48,495 plus any allocation of original cost for the well lot.) The well lot is approximately 1/5 of an acre (9,130 sq. ft.), and it is very unlikely that the original cost of this parcel is more than the difference between the contributed hook-up fees and the cost of the water system. (\$55,000 less \$48,495 or \$6,505) The well lot is considered contributed capital under Rule 103 no matter the cost.

Staff proposes to reflect the hook-up fees as an offset to the plant in service account. Until new plant is added subsequent to and independent of owner development, plant-in-service and hook-up fees will continue to offset each other such that there will be no rate base or depreciation expense to increase rates. It is important to set these accounts up properly now so system capital costs can be properly reflected in future rates. To the extent the Company wants to continue collecting a hook-up fee, Staff recommends that the Company file a request for approval to include this charge in its tariff.

Attachment A, Section A reflects Staff's proposed plant-in-service accounts, reasonable depreciable lives and the annual depreciation. These items are offset by the hook-up fees recorded as Contributions in Aid of Construction and the presumption that water system capital is contributed by the owner/developer through the sale of lots. The amortization of these contributions is shown in Section B.

Staff will assist the Company to set these accounts up properly. Assistance to book any future expansion will also be provided if requested by the Company.

Annual Expenses

The Company did not have any history of annual operating, maintenance, or administrative expenses. It has entered into a contract with Mr. Kirk Marine to provide service to the Company as the certified operator. The compensation for this service will be billed on an hourly rate of \$15.00

per hour plus parts and expenses. Staff interviewed Mr. Marine and received estimates from him concerning annual expenses for the operation and maintenance of the system. Based on Mr. Marine's estimates, Staff prepared a pro forma schedule of annual expenses that the Company could reasonably incur in the operation of the water company. Those estimates are included in the Schedule of Annual Expenses, and attached as Attachment B. The total estimated annual expenses for operating, maintenance and administrative functions total \$3,820. Taxes including property, federal and state are approximately \$1,310 per year. Therefore, the total annual expenses of \$5,160 are the revenue requirement.

Because there is no rate base, no annual depreciation expense is included in revenue requirement. As discussed earlier, all water system investment is recovered through the sale of lots and through hook-up fees.

Estimates are currently used to establish the expense amounts in Attachment B. Therefore, Staff will audit the Company's records for the two years ending December 31, 2007. This will allow a report to be provided to the Company and Commission showing actual expenses, revenues and any additional investments subject to recovery through rates.

Tariff

The Company proposes a monthly rate of \$40.00 per month plus \$4.00 per 1000 gallons for usage over 10,000 gallons. If every customer used no more than the allowed 10,000 gallons each month, the annual revenue generated by the Company at this rate would be \$5,280. When Staff compared the Company proposed rate to those of nearby municipal and private water systems, the proposed rates were found to be higher.

The City of Sandpoint Municipal Water Utility, which is near the Company's proposed service area, established the following rates as of July 2004 for residential use with a ¾ inch connection:

Fixed Monthly Charge	\$7.00
Volume Charge for Every 1,000 Gallons	
First 6,000 Gallons	\$1.45
6,001 – 50,000 Gallons	\$1.70
Over 50,000 Gallons	\$1.95

The Sandpoint tariff structure is much more progressive and has higher commodity charges than have been set for other regulated water utilities in north Idaho. The average consumption by Sandpoint water customers for the 12 month period ending November 1, 2005 was approximately

6,000 gallons this includes all types of residences (multi-family for example). City water utility representatives state that this was for a very wet summer where little irrigation was required. The most recent rate set by the PUC in the area was for Bitterroot Water, located just south of Athol, Idaho (25 miles south of Sandpoint). The average irrigation use in the Sandpoint area for the 5 summer months should be comparable to the 30,000-gallon average used by the customers of Bitterroot water for the five summer months. However, the lots in Kootenai Heights are smaller than at Bitterroot, so it is appropriate to use a lower usage rate. Staff assumed that the summer months' average usage at Kootenai heights would be 24,000 gallons per month or 18,000 gallons per month for irrigation over and above a 6,000-gallon minimum charge allowance. Staff believes that a minimum charge allowance of 6,000 gallons per month is appropriate since the surrounding communities of Sandpoint, Kootenai and Ponderay have tariff structures where 6,000 gallons is a set point.

The rates approved for Bitterroot are a minimum charge of \$21.00 per month and a commodity charge of \$1.73 for every 1,000 gallons over 15,000 in a month. After consideration of these nearby water company tariffs and the Company's revenue requirement, Staff recommends the following tariff:

Fixed Monthly Charge	\$25.00
Volume Charge for Every 1,000 Gallons Over 6,000 in a month	\$ 1.90

This tariff when applied as described above results in annual revenue of \$5,181, or \$21.00 more than the Staff proposed required revenue. The Company has installed individual meters. Staff included expenses related to monthly meter reading and billing in the annual revenue requirement. Monthly billing would provide a good price signal to customers with regard to usage under Staff's proposed rate structures and Staff recommends that the Company read meters and bill on a monthly basis.

CUSTOMER RELATIONS

Kootenai Heights did not provide evidence that it had notified its customers of its Application to the Commission. Therefore, Staff is not sure that customers are aware of the Company's Application. As of March 6, 2006, no public comments had been received by the Commission regarding this case.

According to the Company's Application, purchasers of lots served by Kootenai Heights Water System signed a contract entitled "Kootenai Heights Water Service Agreement and Easement" that includes a number of provisions regarding operation of the water company. Staff does not know whether purchasers of the lots are the same parties who will be receiving water service as customers of the water company. Regardless of whether "purchasers" are also "customers", if the Commission grants the Company's request to become a regulated water utility, Paragraphs 3, 4 and 5 of the contract will be superceded by the Commission's rules as well as Kootenai Height's filed tariff. The Company's tariff will specify water rates, recurring and non-recurring charges, and the terms and conditions of providing service. The Commission's Utility Customer Relations Rules (IDAPA 31.21.01) govern the collection of deposits, billing, disconnection of service, payment arrangements, and dispute resolution. Both the Utility Customer Relations Rules and the Utility Customer Information Rules (IDAPA 31.21.02) govern the provision of information to customers.

Paragraph 3 of the contract specifies that water shall be used "for household domestic purposes in reasonable quantities" and that "Irrigation of yards shall be done at times of low water usage, so as not to interfere with household water uses." The terms "household domestic purposes", "reasonable quantities", and "low water usage" are not defined, and there is no indication of how the Company would propose to enforce these provisions. Staff assumes the provisions were put in place to encourage customers to use water efficiently and to prioritize use inside homes over outside water use. Although Staff does not disagree with that intention, it believes that properly designed rates and provision of information to customers about water conservation and wise water use during the spring and summer will be more effective.

Paragraph 4 specifies a \$5,000 hook up fee. Paragraph 5 sets water rates and specifies under what conditions rates will increase. Paragraph 5 also indicates that the Company will not bill its customers, but customers are expected to pay by the 10th of each month. Customers will be billed semi-annually for "excess water usage over the allowed 10,000 gallons per month". Finally, Paragraph 5 establishes a \$10 late payment fee and a \$50 reconnection fee following termination for non-payment. As stated earlier, the Commission approved tariffs will supercede the rates and charges set forth in the contract on a going forward basis. No cost support was provided to justify the \$10 late payment fee or the \$50 reconnection fee.

Rule 201 of the Commission's Utility Customer Relations Rules (UCRR) requires that customers be billed at regular intervals. Rule 202, UCRR, requires a longer interval between billing

and payment than proposed by the Company. The minimum specified period is 15 days, or 12 days after bills are mailed or delivered, if bills are mailed or delivered more than 3 days after the billing date. Monthly billing of customers is the predominate billing interval used by regulated utilities in Idaho. It is also the best way to give customers immediate feedback on how much water they used and how much it cost. Staff recommends that the Company be required to take meter readings and bill customers each month. This should not be an onerous task for the Company.

Staff recommends that the Commission approve a \$25 reconnection fee. If approved, the \$25 fee would apply regardless of the time of day or day of week that service is reconnected. Because the Company has so few customers, a simple fee structure makes sense. The fee is high enough to discourage customers from not paying their bills and to compensate the Company for costs associated with reconnection.

Staff recommends that the Company not be allowed to collect a \$10 late payment fee. Unlike regulated energy utilities, regulated water utilities are not prohibited from disconnecting customers at certain times of the year. The Commission has allowed water utilities that are unable to discontinue water service easily to assess a late fee for non-paying customers, as would be the case with non-metered systems. However, that is not the case with Kootenai Heights. Finally, a \$10 flat rate fee is excessive. If the Commission chooses to allow the Company to impose a fee on customers who pay late, Staff recommends that any late fee be set at 1% per month on any past due balance carried over from the prior month's bill; this would be consistent with what the Commission has allowed other utilities to charge.

The Company did not file a proposed tariff with its Application, nor has it submitted copies of its proposed bill statements, disconnection notices, or other documents necessary to conduct its day-to-day business. At a minimum, Staff recommends that the Company be directed to file for Staff review and approval the following documents: (1) tariff; (2) sample bill, (3) disconnect notice, and (4) annual summary of rules and rates. A model tariff for small water companies is available, and Staff can provide examples of documents and guidance to the Company upon request.

RECOMMENDATIONS

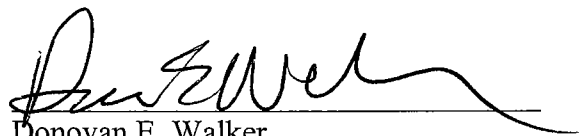
Staff recommends:

- That the Company be granted a Certificate of Public Convenience and Necessity to provide water service to the proposed service area encompassing the 11 residential lots as described in the Application;
- That the Company be directed to adopt and submit a tariff containing the following rates and charges:

Fixed Monthly Charge	\$25.00
Volume Charge for Every 1,000 Gallons Over 6,000 in a month	\$ 1.90

- That the Company be directed to file a \$25 reconnection fee;
- That the Company be directed to file a hook-up fee tariff if it chooses to continue assessing the fee;
- Elimination of the Company’s proposed \$10 late payment fee;
- A late fee is not recommended. However, if one is established, the Commission should direct the Company to file a late fee set at one percent (1%) of any past due balances carried over from the prior month;
- That the Company be directed to take meter readings and bill customers each month;
- That the Company be directed to file for Staff review and approval the following documents: (1) tariff; (2) sample bill, (3) disconnect notice, and (4) annually, a summary of rules and rates.

Respectfully submitted this 9th day of March 2006.


 Donovan E. Walker
 Deputy Attorney General

Technical Staff: Joe Leckie
Carol Cooper
Harry Hall

KOOTENAI HEIGHTS WATER SYSTEM
 Plant-in-Service and Contribution in Aid of Construction

A. Analysis of Plant-in-Service and Annual Depreciation Expense

Plant-in-Service	Depreciable Life*	Plant Investment Value	Annual Depreciation
Well	25	\$ 12,094	\$ 483.76
Distribution System	50	\$ 9,483	\$ 189.66
Pump	20	\$ 17,987	\$ 899.35
Pump House	35	\$ 6,382	\$ 182.34
Total Investment		\$ 45,946	
Total Annual Depreciation Expense			\$ 1,755.11

B. Analysis of Contribution in Aid of Construction and Annual Amortization

	Amortization Term in Years	CIAC	Annual Amortization of CIAC
Amortization of Contribution in Aid of Construction	31	\$ 55,000.00	\$ 1,755.11

KOOTENAI HEIGHTS WATER COMPANY		
Pro-Forma Revenue Requirement		
		Pro Forma
		Annual Est.
Revenues		
Metered Sales		5,280
Expenses		
Operation Expenses		
Purchased Power		600
Supplies & Expenses		100
Water Testing		350
Other		
Total Operation Expense		1,050
Maintenance Expenses		
Maintenance of Well Lot		300
Repairs of Water Plant		200
Other		
Total Maintenance Expense		500
Customer Accounts Expense		
Meter Reading Labor		100
Accounting and Collecting Labor		300
Other		
Total Customer Accounts Expense		400
Administrative & General Expenses		
Administrative & General Salaries		600
Office Supplies & Other Expenses		200
Outside Services Employed		
Certified Operator		600
Property Insurance		250
Regulatory Commission Expenses		150
Miscellaneous General Expenses		100
Total Administrative & General Expenses		1,900
Total Operating, Maintenance and Administrative Expenses		
		3,850
Taxes		
Property Taxes		1200
Income Taxes		
State of Idaho		50
Federal		60
Total Taxes		1310
Total Annual Expenses		5,160
NET INCOME (LOSS)		120

ATTACHMENT C

Company Proposed Tariff

Revenue Requirements = \$5,160.00 annually
 Number of Customers = 11
 Company Proposed Tariff
 Min Charge = \$40.00 per month
 Commodity Charge = \$4.00 per 1,000 gallons over 10,000
 Resulting Annual Revenue
 Min Charge = \$5,280.00
 Commodity = \$3,960.00
 Total = \$9,240.00
 at 90,000 gallons used by each customer over 10,000 per month during a 5 month irrigation period. See note 1.
 at 90,000 gallons used by each customer over 10,000 per month during a 5 month irrigation period

Staff Proposed Tariff

Revenue Requirements = \$5,160.00 annually
 Number of Customers = 11
 Company Proposed Tariff
 Min Charge = \$25.00 per month
 Commodity Charge = \$1.90 per 1,000 gallons over 6,000
 Resulting Annual Revenue
 Min Charge = \$3,300.00
 Commodity = \$1,881.00
 Total = \$5,181.00
 at 90,000 gallons used by each customer over 6,000 per month during a 5 month irrigation period

NOTE 1: Based on an assumed 5 month summer usage of 24,000 gallons per month with 6,000 gallons per month used for culinary and potable purposes.
 5 months X (24000-6000) = 90,000

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 9TH DAY OF MARCH 2006, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF**, IN CASE NO. KHW-W-05-01, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

FLOYD N McGREE PRESIDENT
KOOTENAI HEIGHTS WATER SYSTEM
INC.
PO BOX 1925
SANDPOINT ID 83864

GARY A FINNEY
FINNEY FINNEY & FINNEY PA
120 E LAKE ST SUITE 317
SANDPOINT ID 83864



SECRETARY