DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
COMMISSIONER HANSEN
COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: DONOVAN E. WALKER

DATE: AUGUST 22, 2006

SUBJECT: CASE NO. KHW-W-05-1; KOOTENAI HEIGHTS WATER SYSTEM'S APPLICATION FOR A CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY

On August 22, 2005, Kootenai Heights Water System, Inc. (Kootenai Heights, Company) filed an Application for a Certificate of Public Convenience and Necessity (Certificate) with the Idaho Public Utilities Commission (Commission). On September 30, 2005, the Commission issued a Notice of Application and Modified Procedure establishing a deadline for written comments of November 10, 2005. Order No. 29877. On November 1, 2005, the parties executed a Stipulation asking the Commission to suspend the written comment deadline so that alternative organizational structures for the Company could be explored. The Commission suspended the comment deadline, and directed the parties to report back to the Commission in 60 days. Order No. 29909.

On January 20, 2006, Commission Staff reported that the Company wished to proceed with its original Application. The Commission issued a Second Notice of Application and Modified Procedure, setting a comment/protest deadline of March 9, 2006. Order No. 29960. Commission Staff was the only party to file comments, and recommended that the Company be granted a Certificate of Public Convenience and Necessity. Staff also made several recommendations pertaining to the Company's rates, billing, charges, and customer rules.

THE APPLICATION

The Company submitted various supplemental documents with its Application including: a map of the proposed service area, a Water Service Agreement and Easement form, documents evidencing the incorporation of the Company, a copy of the contract with its Certified

Operator, a copy of a Clarification-Modification of the Plat for Kootenai Heights, and a letter from the Department of Environmental Quality (DEQ) evidencing conditional approval of the as-built plans.

According to the Application the water system is currently in service with six residential customers connected to the system. Application at 2. The Company states that the system will ultimately serve 11 residential customers. *Id.* The requested service area for the water system consists of Lots 7-18 of Kootenai Heights, with the well located on Lot 10. Application at 1. The Company states that the cost to construct the system was $83,500 including the value of Lot 10. Application at 2. The average monthly consumption for the entire system is 31,000 gallons, and the Company states that billing will start on October 1, 2005. *Id.* The Application states that proposed rates and charges, rules and forms are all contained within the Water Service Agreement submitted with the Application. *Id.*

The Water Service Agreement and Easement (WSA) states that the system was developed to provide water "to certain Lots in Kootenai Heights and for further development of additional land and lots in the sole discretion of the Water Provider." WSA at 1. The WSA further provides that each lot shall pay a hook-up fee of $5,000, and that rates will be $40 per month up to 10,000 gallons, and $4 per thousand gallons used over 10,000 gallons per month. WSA at 2. Each customer will be metered, with the cost of the meter and its installation paid by the Company. *Id.* The Agreement states that monthly rates will not be increased for the first five years. WSA at 2-3. Additionally, the Agreement states that monthly bills will not be sent, and the lot owner shall pay the monthly fee on the 1st day of each month. WSA at 3. Billings will be sent to customers twice a year, on or about May 1 and October 1, for the purpose of computing and billing any excess water usage over the allowed 10,000 gallons per month. WSA at 3-4.

STAFF COMMENTS

Commission Staff conducted a review of the Company's Application and financial information. Staff also conducted an on-site inspection of the system. Staff's comments contain: an overview of the water system; a technical review of the physical plant; a financial review with a recommended rate structure; and a discussion of several customer relations/rules issues.

I. Overview of the Water System

Kootenai Heights Water System consists of 11 residential lots with one lot used for a well site and pump house. Floyd and Mickie McGee are the developers of the property and the officers and shareholders of Kootenai Heights Water System. The adjacent area is provided with water service from the City of Kootenai, Idaho, which currently has a moratorium on allowing water users located outside of its established boundaries from connecting to the city's water system. There are no other domestic water suppliers close enough to provide water to the area.

The system consists of one four-inch, five horsepower well pump, with an eight-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 (Lot 10). There is no other water storage in this system. Individual water meters have been installed for each customer.

Kootenai Heights has a Water Service Agreement (WSA) that it proposes as the basis for rates and policies concerning the operation of the water company. The WSA provides for a water usage fee of $40 per month for 10,000 gallons, with excess gallons over 10,000 per month billed at $4 per thousand gallons.

The McGees own additional property adjacent to the proposed service area, and plan to develop this property in the future. Although not a part of this Application, if this property is developed, the McGees would consider combining the water system of the anticipated development with this system.

II. Technical Review of the Water System

Staff determined that the well capacity, as shown from well records and pump data, as well as the three pneumatic storage tanks will be sufficient to serve the present customer base. The Company has hired a certified operator to manage the water company and appears to have the financial ability to maintain adequate service.

The Department of Environmental Quality (DEQ) approved the existing system in January 2005, contingent upon full compliance with five items set out in the approval letter. As of the time that Staff filed its comments, a DEQ engineer had advised Staff that all but one of the five requirements had been met, and the remaining requirement would require several more months of testing to determine compliance. Additionally, the Panhandle Health District reviewed and inspected the system in February 2005. The system was found to be in substantial compliance with IDAPA 58.01.08, and nine required improvements, and two suggested improvements, were communicated to the Company's certified operator.

III. Financial Review of the Water System

A. Rate Base – The Company has indicated in the documentation filed with the Application that it incurred the following costs 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	$ 3,500
Total	$ 48,495

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

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 square feet), 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. Staff cautions that 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 to Staff's comments reflects 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 offered to assist the Company to set these accounts up properly, and to properly book any future expansion if requested by the Company.

B. Annual Expenses/Revenue Requirement – Since there is no rate base, Staff examined the Company's annual operating expenses in order to set a just and reasonable rate. Because there is no history of annual operating, maintenance, or administrative expenses, Staff interviewed the Company's certified operator and received estimates from him concerning annual expenses for the operation and maintenance of the system.

Based on the certified operator'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 to Staff Comments. Staff proposes to audit the Company's records for the two years ending December 31, 2007, in order to update the estimated annual operating, maintenance, or administrative expenses based on actual expenses, revenues, and any additional investments subject to recovery through rates. Because there is no rate base, no annual depreciation expense is included in the revenue requirement. As discussed earlier, all water system investment is recovered through the sale of lots and through hook-up fees. 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, Staff recommends that the total annual expense of $5,160 be set as the Company's annual revenue requirement.

C. Rates – The Company proposes a monthly rate of $40 per month plus $4 per 1,000 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.

Staff compared the Company's proposed rates to those of nearby municipal and private water systems, and the proposed rates were found to be somewhat higher. 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 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 rates approved for Bitterroot are a minimum charge of $21 per month and a commodity charge of $1.73 for every 1,000 gallons over 15,000 in a month. 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 3/4 inch connection: fixed monthly charge of $7, volume charge for every 1,000 gallons, with the first 6,000 gallons at $1.45, 6,001-50,000 gallons at $1.70, and over 50,000 gallons at $1.95 per gallon. 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.

After consideration of the nearby water company rates and the Company's revenue requirement, Staff recommends the following rates:

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

These rates when applied as described in Staff's comments result in annual revenue of $5,181, or $21 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.

IV. __Customer Relations Issues__

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" (WSA) that includes a number of provisions regarding operation of the water company that are covered by or are in conflict with the Commission's Utility Customer Relations Rules, and should be included in the Company's tariff that is filed with the Commission. When asked on the Application Form to attach samples of the Company's bill statement, reminder notice for termination of service, final notice for termination of service, rules summary, and utility's general rules and regulations the Company states that all are within the Water Service Agreement. Additionally, as previously noted, when asked to attach a description of proposed rates and charges the Company refers to the WSA.

Kootenai Heights 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. The Company did not provide evidence that it had notified its customers of its Application to the Commission. As of March 6, 2006, when Staff filed its comments the Commission had received no public comments. Staff recommends that the Company be directed to file for review and approval the following documents: (1) tariff; (2) sample bill; (3) disconnect notice; and (4) a 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.

The Company's tariff should specify water rates, recurring and non-recurring charges, and the terms and conditions of providing service. Paragraphs 3, 4, and 5 of the Company's WSA conflict with the Commission's Customer Relations Rules and/or address issues that are required to be in the Company's filed tariff. 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." 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 10^{th} 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. 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 the Company be required to take meter readings and bill customers each month.

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.

STAFF RECOMMENDATIONS

Staff recommends that:

(1) 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, and that it continue to work to comply with the requirements of DEQ and the Health District;

(2) The Company be directed to adopt and submit a tariff containing the following rates and charges: a fixed monthly charge of $25 and a volume charge of $1.90 for every 1,000 gallons over 6,000 gallons per month, and a $25 reconnection fee;

(3) The Company be directed to file a hook-up fee tariff if it chooses to continue assessing the $5,000 hook-up fee;

(4) The Company be directed to take meter readings and bill customers on a monthly basis;

(5) The Company's $10 late payment fee be eliminated. Staff does not recommend any late payment fee, however, if the Commission wishes to authorize a late payment fee, Staff would recommend a fee of 1% of any past due balances carried over from the prior bill;

(6) The Company be directed to file for Staff review and approval the following documents: (1) tariff; (2) sample bill; (3) disconnect notice; and (4) a summary of rules and rates.

COMMISSION DECISION

Does the Commission wish to grant a Certificate of Public Convenience and Necessity to Kootenai Heights Water System? *Idaho Code* § 61-526.

If so, what does the Commission authorize as just and reasonable rates, charges, rules, and regulations that the Company may charge and impose on its customers? *Idaho Code* §§ 61-301, 61-303. Does the Commission wish to impose any conditions upon the grant of a Certificate in order to ensure the maintenance of adequate service by the Company? *Idaho Code* § 61-302.

DONOVAN E. WALKER

M:KHW-W-05-01_dw4

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 B
Case No. KHW-W-05-1
Staff Comments
03/09/06

Kootenai Heights Water
7-Mar-06

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	at **90,000** gallons used by each customer over 10,000 per month during a 5 month irrigation period. **See note 1.**
Total =	$9,240.00	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	at **90,000** gallons used by each customer over **6,000** per month during a 5 month irrigation period
Total	$5,181.00	

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

Attachment C
Case No. KHW-W-05-1
Staff Comments
03/09/06