Dean J. Miller
McDEVITT & MILLER LLP
420 West Bannock Street
P.O. Box 2564-83701
Boise, ID 83702
Tel: 208.343.7500
Fax: 208.336.6912
joe@mcdevitt-miller.com

Attorneys for United Water Idaho Inc.

RECEIVED
FILED
2006 JUN -9 PM 1:49
IDAHO PUBLIC
UTILITIES COMMISSION

SUP-W-05-01

ORIGINAL

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

UNITED WATER IDAHO INC., Appellant, vs. IDAHO PUBLIC UTILITIES COMMISSION, Respondent.	**SUPREME COURT DOCKET NO. 32431** **IPUC Case No. UWI-W-04-04** **RESPONSE TO STAFF'S OBJECTION TO CLERK'S RECORD**

COMES NOW United Water Idaho Inc., ("United Water," the "Company") and responds to Staff's Objection to Agency Record as follows, to wit:

<u>Prior Orders</u>

Staff's Objection requests that prior Commission Order No. 25062 (Case No. BOI-W-93-1) be included in the Agency Record.

United Water is not certain that inclusion of this prior order in the Record is necessary. United Water assumes, and is prepared to stipulate, that the Supreme Court may take judicial notice of prior orders without their inclusion in the record. *See* Idaho Code 9-101:

> Courts take judicial notice of the following facts:
> (3). Public and private official acts of the legislative, executive and judicial departments of this state and of the United States.

Further, the Idaho Appellate Rules discourage inclusion of un-necessary material in the Record. Idaho Appellate Rule 19, "Request for additional transcript or agency record," provides:

> If the court concludes that a party or attorney has vexatiously or unreasonably increased the cost of litigation by inclusion of irrelevant materials, the court may deny that portion of the costs the court deems to be excessive and/r impose monetary sanctions. Notice and an opportunity to respond shall be provided before sanctions are imposed.

If, however, the Commission is inclined to include one prior order relating to United Water (or its predecessors), then it should include all relevant prior Orders. Attached hereto are Order Nos. 25640, Case No. BOI-W-93-3, Order No. 27617, Case No. UWI-W-97-6, and Order No. 28505, Case No. UWI-W-00-1. If the rate case order from the 1993 case is to be included, as requested by Staff, these subsequent rate case orders should be included as well.

<u>Notice of Intent to File General Rate Case</u>

Staff has additionally requested that United Water's Notice of Intent to File General Rate Case dated November 30, 2005 be included in the Record. In support of this, Staff asserts, only vaguely, that the Notice is "...relevant and necessary for a full adjudication of this matter on appeal, specifically regarding Appellant's statement of issues in the Notice of Appeal concerning constitutional taking of property." (Staff Objection, Pg. 3).

United Water respectfully contends that the Notice of Intent is irrelevant to the issues in the pending appeal.

Dated this 9 day of January, 2006.

MCDEVITT & MILLER LLP

Dean J. Miller
Attorneys for United Water Idaho Inc.

CERTIFICATE OF SERVICE

I hereby certify that on the 9th day of January, 2006, I caused to be served, via the method(s) indicated below, true and correct copies of the foregoing document, upon:

Weldon B. Stutzman Donovan E. Walker Deputy Attorneys General IDAHO PUBLIC UTILITIES COMMISSION P.O. Box 83720 Boise, ID 83720-0074	Hand Delivered U.S. Mail Fax Fed. Express Email	☑ ☐ ☐ ☐ ☐
Clerk of the Courts IDAHO SUPREME COURT P.O. Box 83720 Boise, ID 83720-0101	Hand Delivered U.S. Mail Fax Fed. Express Email	☐ ☑ ☐ ☐ ☐

Legal Asst

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF BOISE WATER CORPORATION TO REVISE AND INCREASE ITS RATES CHARGED FOR WATER SERVICE.	)))))	**CASE NO. BOI-W-93-3** **ORDER NO. 25640**

SYNOPSIS

This is a final Order determining the revenue requirement and setting new rates for Boise Water Corporation (Boise Water; Company). By this Order, we authorize Boise Water to increase its revenues by $3,665,144 or approximately 22.59%.

SUMMARY

On December 16, 1993, Boise Water filed an Application for authority to increase its rates and charges for water service. The Company revised that filing in early 1994 and now seeks to increase its rates by $6,348,575 or approximately 43.52%. Included with the Company's Application was a cost of service study recently performed on behalf of Boise Water. Based on that study, the Company proposes revising and increasing the number of customer classes.

On January 7, 1994, the Commission issued Order No. 25326 suspending Boise Water's proposed rates for a period of 30 days plus five months from the proposed effective date of January 15, 1994. On May 31, 1994 through June 2, 1994, the Commission conducted an evidentiary hearing in this case.

I.

Appearances were made by the following parties:

BOISE WATER CORPORATION:	Walton F. Hill, Esq. General Water Works Management & Service Company 2004 Renaissance Blvd. King of Prussia, PA 19406-2758 Kenneth Bergquist, Esq. 910 Main Street, STE 348 Sonna Blg. Boise, ID 83701
COMMISSION STAFF:	Lori Mann Deputy Attorney General Idaho Public Utilities Commission PO Box 83720 Boise, ID 83720-0074
COALITION OF BOISE WATER CUSTOMERS (CBWC):	Peter J. Richardson, Esq. Davis, Wright, Tremaine 999 Main Street, STE 911 Boise, ID 83702
IDAHO CITIZENS COALITION (ICC):	Al Fothergill 9220 W Wright Street Boise, ID 83709
SHARON ULLMAN	Appearing Pro Se 9687 W Desert Ave. Boise, ID 83709

Boise Water proposes a rate base of $69,630,392. By this Order, we make the following adjustments to that proposed rate base: [1] the elimination of Boise Water's investment in the Pierce Park/Gary Lane line extension; [2] the disallowance of prospective capital expenditures; [3] the elimination of a post-closing allowance for funds used during construction (AFUDC) related to the Marden Street treatment plant, and; [4] the elimination of that portion of Boise Water's investment in the Marden Street plant relating to excess capacity. We approve a rate base for Boise Water of $67,218,005.

We also make numerous adjustments to the Company's proposed operating results including: [1] an adjustment to test year consumption data to reflect the usage of new customers connected to the system during the test year; [2] the weather normalization of test year consumption data as proposed by Staff; [3] the elimination of lost revenues related to conservation; [4] the elimination of an inflation adjustment; [5] the elimination of prospective expenses, and [6] a reduction of the Company's rate case expense.

We adopt a return on equity for Boise Water of 11.25% and an overall rate of return of 9.51%. This yields a revenue deficiency of $3,665,144, which we allocate by equal percent increase to the Company's commodity charge for all customers. We direct the Company to begin compiling customer class specific usage data to aid in the future implementation of class specific rates. By this directive, we do not endorse the Company's customer class definitions.

The current bimonthly customer minimum bill for a 3/4 inch or smaller meter is $16.71, which includes 1,000 cubic feet of water usage. We hereby reduce the customer minimum to $12.00 for a 3/4 inch or smaller meter and eliminate the 1,000 cubic foot allowance. Customers will henceforth be billed for all water usage at the rates approved in this Order. The bimonthly customer minimum bill for all other meter sizes will be reduced proportionately and their usage allowances are also eliminated.

We modify the seasonal rate structure adopted in Boise Water's last general rate case. The summer commodity price will remain approximately 25% above the non-summer price. The summer period will change from the current split, four months to five months from May 1 to September 30. We increase the Company's hookup fees for its smallest meters from the current level of $190 to $1,200. Hookup fees for all other meter sizes will be increased proportionately. For prospective customers connected to a separate irrigation system, however, there shall be a discounted hook-up fee of $465 for 3/4 inch and smaller meters. Larger metered customers shall receive proportional discounts. Finally, we award intervenor funding to ICC in the amount of $13,790.37 and to CBWC in the amount of $11,209.63.

FINDINGS

1. TEST YEAR

Boise Water proposes a test year ending December 31, 1993 with operating results adjusted through June 30, 1994. Staff objects to some of the adjustments but all parties agree with the proposed test year.

We find:

The use of a test year ending December 31, 1993 is reasonable for the purposes of this rate case. As discussed later, however, we do not allow prospective adjustments to operating results which are not known and measurable.

II. RATE BASE

Calculation

Boise Water calculates its rate base as of December 31, 1993 adjusted for budgeted changes. In Order No. 25062 issued in the last general rate case we ordered Boise Water to present, as an option, a 13 month average calculation of rate base in this case.

We find:

According to Staff, Boise Water's rate base would be $1,163,281 lower if calculated based on a 13-month average as opposed to year end. While it might be advantageous to ratepayers to have a lower rate base, no party challenges Boise Water's proposal to utilize a year end rate base. Boise Water's customer base and its investment in plant are both growing rapidly. A year-end calculation of rate base for a utility experiencing rapid growth is, in this case, a more accurate reflection of that utility's investment in plant. In light of the foregoing and the absence of objection, we find that a year-end calculation of rate base for Boise Water is fair, just and reasonable.

Marden Street Plant

Boise Water's Ranney collectors accumulate water percolated down from the surface near the Boise river. They currently have a capacity of approximately 5.3 million gallons per day (MGPD). It was recently determined that the water from the Ranney collectors was not potable without treatment. The Marden Street plant was constructed to treat the water from the Ranney collectors. It currently has a capacity of 8 MGPD with an ability to expand to 16 MGPD in the future.

CBWC objects to the inclusion of any Marden investment in rate base on several grounds. First, the Coalition argues that Marden is not a cost-effective acquisition when compared with other resources. Witness Reading uses the $15.9 million investment in Marden to calculate a $2 million investment per MGPD. By the Company's own statement, he argues, other treatment plants could be constructed at $1.2 million per MGPD. Second, Reading argues that Marden is over sized. In spite of the Company's contention that the entire plant will serve existing customers, he argues that the additional 8 MGPD in potential capacity is being held for future use even though current system customers are being asked to pay for 83% of the cost of the project, but receiving only half of its capacity. Reading characterizes Marden's excess capacity as plant held for future use without any assurance as to its necessity. He contends that it is inappropriate to ask existing ratepayers to underwrite Boise Water's gamble that the excess capacity of Marden will ever be used and useful.

Reading recognizes that there are economies of scale in constructing a plant with excess capacity but contends that the benefits of these economies will be realized only if the demand for water in southeast Boise occurs as predicted by the Company.

Reading points out that Boise Water does not have water rights to supply Marden at its full 16 MGPD capacity. In fact, he argues, the Company does not even have sufficient water rights to run Marden at a full 8 MGPD during the winter months. Reading argues that the majority of surface water rights that Boise Water owns are from an irrigation company and are available only in the summer. He suggests that what the Company is attempting to do is to take surface irrigation water, process it through an expensive water treatment plant, and use it to fulfill summer irrigation demand. Again, Reading argues that Boise Water may never obtain the necessary surface water rights to run Marden at its full capacity and existing ratepayers should not be asked to pay for that portion of the excess capacity which is not used and useful. Reading argues that Boise Water never even considered separate irrigation systems as an alternative option when it decided to build the Marden Street plant. He recommends that the Commission allow into rate base only that portion of Marden that is in fact used and useful; that is, only the plant necessary as replacement for the current Ranney collectors, i.e., the first 8 MGPD.

In rebuttal, Boise Water argues that it was faced with the loss of the Ranney collectors under the Safe Drinking Water Act (SDWA) unless it took immediate action. The only viable option, the Company contends, was to construct Marden. Along those lines, the design of potential, future excess capacity into Marden was a prudent and fiscally responsible decision.

Furthermore, Boise Water argues that separate irrigation systems were not and are not a viable alternative to the construction of Marden to meet the immediate source of supply needs within the main service level that would have been created by the loss of the Ranney collectors. First, the Company could not have forced the existing customers within the service level to install costly, separate irrigation systems. Furthermore, the work could not have been accomplished by July, 1993 when the Ranney collectors would have been taken out of service if not treated.

Boise Water disputes Reading's contention that the cost of Marden is $2 million per MGPD. The $1.2 million per MGPD estimate provided by the Company is based upon the estimate of $18.2 million for the upgraded 16 MGPD Marden plant. The cost per MGPD of a new surface water treatment plant is directly related to the size or production capacity of the plant. The larger the capacity the lower the cost per MGPD. Boise Water argues that there is no deliberately constructed excess capacity in the plant. It is strictly an 8 MGPD plant that will be totally utilized to serve existing customers with an option to expand to 16 MGPD in the future, the Company contends. Boise Water concedes, however, that approximately $530,000 of its total investment in Marden relates to the option to expand the plant's capacity to 16 MGPD.

We find:

No party to this proceeding, including CBWC, disputed Boise Water's argument that the Ranney collectors would be lost under the SDWA unless a treatment plant was constructed. Given the significance of the Ranney collectors, we believe that the Company would have been derelict in failing to preserve that resource unless another more cost-effective option were available. We are not convinced by CBWC's arguments that separate irrigation systems presented such an alternative. The Ranney collectors are used to meet the supply needs within the main service level. Separate irrigation systems were not a viable option for this existing customer base.

We also cannot accept CBWC's contention that Marden is not used and useful. As the Company points out, the plant was constructed with a capacity of 8 MGPD with an option to expand to 16 MGPD. The entire capacity of the plant is currently being used. With the exception of the approximate $530,000 of the Company's investment attributable to the option to expand to 16 MGPD, therefore, we find that the Company's investment in Marden was prudent and that the plant is used and useful and should be included in rate base. We find that, although the $530,000 invested in the option to expand the capacity of Marden in the future was a prudent investment, it is not yet used and useful and should be classified as plant held for future use. Although the investment in the option to expand the capacity will not be allowed in rate base, the Company will be allowed to amortize the $530,000 investment over the life of the plant.

Post Closing Marden AFUDC

Boise Water proposes including $533,096 in post closing AFUDC costs related to Marden in rate base. The costs are calculated for the period May 1, 1994, when the treatment plant was expected to be placed into service, to August 31, 1994, when Boise Water anticipates that its new rates will go into effect.

Staff opposes the inclusion of post closing Marden AFUDC into rate base. Witness Pline argues that Boise Water is asking the Commission to perfectly match the Company's investment in Marden and its return on that investment even though, over the life of the project, there will be many instances when the amount of the plant which is included in rate base and earning a return will not match the actual book value of the plant.

Staff contends that there is seldom an attempt to perfectly synchronize earnings and investment. Just as there is a period of time between placing a plant in service and including its costs in rate base, there is a period of time between a plant's retirement and its removal from rate base. Theoretically, these two time frames and the excess and deficient revenue earned over the life of the plant offset each other. Recognizing post closing AFUDC costs increases the utility's revenue requirement and increases the rate base used to calculate a rate of return. Staff could not find any instance in which the Commission allowed post closing AFUDC.

In rebuttal, Boise Water argues that even Staff does not deny that capital costs associated with Marden continue even after it is placed in service. The Company asserts that other jurisdictions have allowed post closing AFUDC in rate base and so has this Commission in the treatment of Idaho Power Company's conservation investments.

We find:

We agree with Staff that during the life of a plant there will be many instances when the amount in rate base will not match the actual book value of the plant. Over the life of the plant, however, the utility is made whole. That is why this Commission has not historically allowed post closing AFUDC. Boise Water did not provide any rationale for departing from the traditional manner in which we treat this cost. The Company's assertion that the Commission has allowed post closing AFUDC for Idaho Power conservation investments is erroneous. The interest on investment was allowed as an incentive to initiate the conservation programs. It is not an investment in backbone plant. We hereby disallow post closing AFUDC for Marden.

Pierce Park Lane Line Extension

As in the last Boise Water general rate case, the Company requests that a portion of its investment in the Pierce Park/Gary Lane main line extension be allowed in rate base. Boise Water never collected the costs of the main line extension from developers through its existing tariffs or through the special facilities charge as the Company originally proposed. It argues that the line extension should still be allowed in rate base because, due to growth in the area, it is already serving 296 out of a potential 800 customers. The Company argues, therefore, that at least three-eighths of the main line cost should be allowed to be recovered from ratepayers. The Company also contends that the hookup fees paid by customers connecting to the main line cover some of the main line costs.

Staff argues that the line extension should be entirely disallowed from rate base. Staff contends that Boise Water originally agreed to recover the cost of the line extension from developers through a special facilities charge. The Commission noted this in Order No. 24109. The Commission also noted that if Boise Water wished to expand into that area, that it did so at the risk of having to compete with Garden City. Staff argues that Boise Water found itself in a bidding war with Garden City and that is why it never attempted to recover the cost of the main line through the relatively more expensive special facilities charge. Now, Staff argues, Boise Water expects existing ratepayers to fund the cost of the main line when the Company violated its own agreement to recover those costs from developers.

Finally, Staff points out that all revenue generated by customers served, including hook-up fees, must be applied to the revenue requirement associated with the facilities within the subdivision and not to the cost of the main line extension.

We find:

In both Case Nos. BOI-W-91-2 and BOI-W-93-1 we expressed concern that Boise Water's decision to move into the Pierce Park Lane area and compete with Garden City might have an adverse financial impact on existing ratepayers. In Order No. 25062 issued in Case No. BOI-W-93-1, we ruled:

> In spite of our explicit mandate, issued January 24, 1992, Boise Water has failed, without explanation, to submit a special facilities contract relating to the Pierce Park line extension project. . . . The fact is simply that, as we stated in BOI-W-91-2, we have a valid concern whether the Company's ratepayers have been adequately protected from costs Boise Water has incurred in competing with Garden City. We find, therefore, that the Company's investment in the Gary Lane project should not be included in rate base until a special facilities contract previously required for the project has been submitted.

Order No. 25062 at p. 7.

Boise Water never filed the special facilities contract nor any supporting documentation as directed in Order No. 25062. We find no reason, therefore, to alter our decision made in the Company's last general rate case. The Company's investment in the Pierce Park Lane line extension shall not be included in rate base. This results in a net adjustment to the Company's proposal (after subtracting depreciation) of $273,000.

Prospective Capital Expenditures

Boise Water has included in rate base a number of capital expenditures which are included in the Company's 1994 budget but, at the conclusion of the Staff's field audit in March, 1994, had not yet been made. These expenditures range from transmission main replacement to the acquisition of new office furniture. Staff proposes summarily disallowing all prospective capital expenditures from rate base on the basis that they are purely budget estimates subject to modification and cancellation and should not be allowed except under extenuating circumstances. Staff contends that the Commission has never accepted pure budget estimates of minor projects as known and measurable rate base adjustments regardless of their composite valuation. The prospective capital expenditures Staff recommends disallowing from rate base total $1,673,760.

In rebuttal, Company witness Walker testified that many of these particular projects have been put to beneficial service while the remainder will be put to beneficial service by the end of May 1994.

We find:

We cannot allow Boise Water to include in rate base capital expenditures which are merely budgeted for and have not been placed into service. Furthermore, the purpose of selecting a test year is to provide a cut off date which is necessary to establish rates in a general rate case. While we do allow adjustments for known and measurable changes, the items identified by Staff, as of the date of Staff's audit, were merely budgeted for and, as such, were subject to modification and cancellation. Thus, they do not constitute known and measurable changes and should be disallowed from rate base.

Working Capital

The Company included in its updated filing a calculation for a working capital allowance of $1,505,055 using the balance sheet adopted in the last general rate case. No party other than Staff addressed this issue. Staff noted that the Company erred in some of the account classifications and offered its own calculation which produced an allowance of $863,000. In rebuttal, Boise Water proposed several adjustments to Staff's calculation which Staff did not oppose. Staff's working capital adjusted for the unopposed Company adjustments produces a working capital allowance of $1,389,724.

We find:

We hereby adopt a working capital allowance in the amount of $1,389,724 as agreed to by Staff and the Company.

Rate Base Calculations

Following are the calculations for Boise Water's approved rate base:

Plant in Service		
Actual Year-End Plant in Service	85,184,159	
Add Marden Street Plant	15,389,000	
Less Marden Plant Held for Future	(530,000)	
Add Hulls Gulch Reservoir	1,631,000	
Eliminate Investment in Pierce Park	(283,000)	
Adjusted Total Plant in Service		$101,391,159
Less:		
Actual Year-End Accumulated Depr.	16,561,479	
Remove Depr. on Pierce Park Line	(10,000)	
Correct Depr. on Marden Eng Fees	(46,419)	
Year-End Accum Amort of CIAC	1,634,123	
Retirement Work in Prog Year-End	(26,460)	
Adjusted Accum Depr & Amort		(18,112,723)
Less:		
Actual Y.E. Customer Adv. for Const.	3,308,748	
Actual Year-End Contrib. in Aid of Const.	12,077,065	
Less Accum Amort of CIAC	(1,634,123)	
Less CIAC on Plant not in Serv.	(91,232)	
Post Y.E. Marden St. Plant Contrib	280,000	
		(13,940,458)
Less Utility Plant Acquisition Adjustment		(24,158)
Less Actual Year-End Deferred Inc. Tax		(3,844,600)
Less Actual Y.E. Bal of Pre 1971 Invest Tax Cr.		(27,948)
Less Unamortized Bal of After Tax Gain on Office Bldg.		(8,879)
Add Year-End Balance of Deferred Charges		395,888
Add Working Capital Allowance		1,389,724
Total Rate Base		67,218,005

III. OPERATING RESULTS

Weather Normalization for Test Year Consumption Data

Staff argues that the water consumption data for the test year is understated because of the abnormally cool, wet summer of 1993. Staff notes that June and July of that year were a combined 126% above normal precipitation and the summer period was 7% below average temperature. Staff presented an exhibit showing the decrease in agricultural pumping for the period June through October 1993 compared to weather normalized loads for the same period. Using a linear regression technique with water consumption per customer as the dependent variable and rainfall and temperature as the independent variables, Staff calculates a proposed weather normalization adjustment of 987,000 ccf for the residential customer category and approximately 336,000 ccf for the commercial customer category. Consequently, Staff proposes that total test year consumption be increased from 14.2 million to 15.77 million ccf or 11%.

In its direct case, the Company weather normalized when it calculated its claimed lost revenues due to conservation. Boise Water does not disagree with a weather normalization adjustment but argues that it should be in the amount included in its direct case. In rebuttal, Boise Water also proposes implementing a "revenue reconciliation clause" which would compare actual to forecasted revenue and production costs and surcharge or refund the difference to customers through a single annual billing adjustment made as a charge or credit per ccf that relates to consumption during the November and December billing periods.

Staff objects to the introduction of a new concept so late in the process depriving them of the opportunity to study and analyze the proposal in detail. Staff also objects to the proposal as the introduction of a new element into the case which is not appropriate nor responsive in a rebuttal filing.

We find:

In order to account for the abnormal weather experienced during the Company's peak season of the test year, and to more accurately portray the Company's revenues, it is necessary to normalize test year consumption data. Staff's method of normalization is reasonable, relatively straight forward and is hereby adopted. The Company's proposed weather normalization, while not entirely unreasonable, is unnecessarily complex. We agree that Boise Water's higher R-squared correlation factor is due to its use of monthly data rather than annual data and that the Company offers no more explanation of annual consumption than Staff's method.

Regarding Boise Water's revenue reconciliation proposal, we find that, regardless of its merit, the evidentiary record in this case is not adequate to approve such a mechanism. If the Company were serious about pursuing this, it should have made the proposal in its direct filing so that all parties would have a reasonable opportunity to respond. Boise Water is free to present this proposal in another filing. We agree with

Power, however, that a revenue reconciliation mechanism would reduce the Company's risk and this should be reflected in the allowed rate of return.

Lost Revenues

Boise Water claims $378,547 in lost revenues resulting from its conservation programs. The Company submitted its final conservation plan in August 1993. Company witness Shiflet discussed Boise Water's various conservation programs. In the last rate case, the Commission refused to allow Boise Water any lost revenues because the Company had not filed its formal conservation plan and the statistical theory presented by the Company's witness was unconvincing. Mainly, the Company had failed to account for weather related variations in water usage.

In the present case, Boise Water offers the testimony of witness Maddaus who, using a linear regression modeling technique, attempts to account for weather variables in calculating the effect that the Company's conservation programs have had on customer usage.

Staff argues that Boise Water is not entitled to any lost revenues resulting from its conservation programs. Staff witness Eastlake testified as to the general concept of lost revenues. He argues that lost revenues should be allowed only where the conservation plan as a whole is of material size relative to the overall costs and/or revenues of the utility involved. More importantly, he argues that the hypothesized savings and the accompanying lost revenues must be the result of actions undertaken directly by the utility.

Eastlake asserts that the Commission cannot condone retroactive ratemaking nor should it compensate the utility for all the ordinary risks of doing business that might cause sales to decline. Eastlake contends that lost revenue recovery is not meant to be an automatic revenue stabilizer for water companies. Furthermore, income generation is not the major goal of conservation programs. Eastlake argues that lost revenues which occur as a result of new codes or regulations should be accounted for through a rate case which reactively asks for a rate increase to reflect known and measurable sales declines due to such codes. Alternatively, such code impacts could be dealt with specifically in sales forecasts which, again, are incorporated in base sales levels in a general rate case.

Eastlake notes that 76% of the savings set out in Boise Water's conservation plan come from federal regulations included in the Energy Policy Act. He argues that the so called "plumbing code" portion of the plan, although it will result in some savings, should not be eligible for any lost revenue consideration because it is entirely outside the control of Boise Water. Eastlake concludes that, given the uncertain nature and small size of the savings associated with the Company initiated programs and the equally small amount of costs that were incurred in conservation programs, the Commission should disallow any consideration of lost revenues in the present case but allow discussion of the issue in the future.

Staff witness Lobb argues that the actual 1993 test year consumption already reflects any reduced consumption that might have occurred as a result of the Company's conservation programs. In other words, the conservation claimed to have occurred in 1993 is reflected in lower actual consumption. The revenue requirement is spread over this lower consumption total resulting in rates that are higher. By subtracting estimated 1993 conservation from actual 1993 consumption, the Company is double counting the effect of conservation, Lobb argues. He asserts that this adjustment is both retroactive and an inappropriate pro forma adjustment to test year consumption.

Furthermore, Lobb argues that the bulk of the Company's conservation plan involves the installation of low flush toilets and low flow shower heads in new construction. He posits that this is an inappropriate adjustment to an historic test year because the water savings would relate to future customers not yet served. Other proposed conservation measures, including a pilot audit program designed to determine water savings and an education program, do not provide known and measurable water savings and, therefore, are inappropriate test year pro forma adjustments, he contends.

The Coalition of Boise Water Customers also opposes the allowance of lost revenues related to conservation. CBWC's witness Reading objects to the Company's calculation of lost revenues because it uses a "pre-conservation" base line period that ends in 1990 so that the years 1991 through 1993 are part of the adjustment period. This is done in spite of the fact that the Company had no official water conservation program until 1994.

Furthermore, to the extent that the Company did have elements of a conservation plan in place in the early 1990's, Reading argues that it has presented no evidence that the reduced usage in those years is a direct result of conservation measures. Reading suggests that Boise Water's customers have had the good sense to curtail their water consumption during drought years.

Finally, Reading argues that the Company's approach to calculating lost revenues is retroactive and, to be empirically verifiable, the loss of revenues must be tied to an explicit forward looking methodology as ordered by the Commission in the last general rate case. Reading argues that the Company's conservation plan does not attempt to measure the results of its implementation or to quantify the way in which any given program has contributed to any alleged decrease in usage.

Reading criticizes the Company's linear regression calculations as failing to take into account other factors that might affect water use including the public's general awareness of the drought conditions existing in southern Idaho. Reading also argues that other factors exist which affect water usage including new appliances which are more water efficient, the effect of prior rate increases on customers' usage behavior and the fact that lot sizes in new construction are typically smaller resulting in less per account usage.

Reading also notes that the Company's interim water conservation plan did not begin until mid 1991 and the official plan has just gone into effect. In spite of this, significant savings are being attributed to Company actions in calendar years 1991-1993 without documentation.

The Idaho Citizens Coalition also opposes lost revenues due to conservation. ICC witness Power argues that even if Boise Water's contentions are correct and the Company's conservation programs have reduced consumption, this reduction in consumption by customers is already reflected in the test year consumption data. When that lower consumption level is used to set rates in this case, any lost revenues associated with that 1993 conservation will automatically be made up. Power argues that Boise Water cannot use both the actual 1993 consumption levels that include the impact of conservation and ask for this conservation adjustment to be made. Power contends that Boise Water is attempting to employ retroactive ratemaking by setting rates for the future that will allow it to recover revenues it thinks it ought to have been allowed to earn last year but which the Commission denied.

Power criticizes Boise Water's linear regression technique for failing to provide confidence intervals for the estimates of the effects of the water conservation programs. He contends that this leaves the Commission with a request that it use an estimate of unknown statistical reliability to bill customers for conservation impacts which may be zero.

Power notes that customer usage actually began to decline prior to the implementation of the Company's conservation plan. He suggests that it is simply impossible to quantify all the factors that determine water usage and, consequently, it is impossible to accurately calculate the effect of Boise Water's conservation programs.

Power recommends that the Commission continue to insist that Boise Water pursue all cost effective conservation programs, but until all those programs involve very specific measures with substantial impacts that can be reliably measured, lost revenue recovery should be disallowed. In rebuttal, Boise Water contends that Staff fails to recognize that the Company correctly predicted reduced consumption in the last rate proceeding but was not permitted to recover lost revenues.

We find:

In Order No. 25062 issued in Boise Water's last general rate case, we rejected the Company's request for lost revenues because the Company had not yet filed its conservation plan. We also found that its statistical theory, which was based upon the assumption that all variation in water usage not related to rainfall was due to conservation, was not convincing. See Order No. 25062 pp. 9-10.

In the present case, Boise Water employed a linear regression technique for calculating lost revenues. In the Company's last general rate case, we rejected the use of such a technique stating:

> In short, Boise Water's analysis left far too many questions unanswered and failed to present quantifiable, verifiable evidence to convince us that the Company's conservation efforts are responsible for lost revenues of the magnitude claimed by Boise Water or, for that matter, any lost revenues at all.

Order No. 25062 at p. 10.

We went on to rule:

> However, to receive such treatment, programs must be identified and approved in advance of implementation. They must also be capable of yielding reasonably measurable results. We do not believe that linear regression methods such as those presented in this case provide the measurement needed.

Id. at p. 11.

In assessing any utility's request for lost revenue, one must first examine the conservation programs the utility claims are responsible for the lost revenues. We now have the benefit of analyzing Boise Water's conservation plan filed following the last general rate case. While the plan contains some programs that are desirable, the bulk of it appears to relate to building codes, i.e., the new plumbing code and installation of low-flow showerheads. In Order No. 25062, we informed the Company that we would consider lost revenues "only on a prospective basis and only to programs that have measurable costs and benefits." Order No. 25062 at p. 11.

While the installation of low-flow showerheads and the education of young children regarding water conservation is certainly desirable from a public policy standpoint, it does not rise to the level necessary to justify the recovery of lost revenues. Furthermore, we agree with Staff and ICC that Boise Water's analysis is defective in its failure to account for the fact that reduced consumption during the test year is already reflected in consumption data. Finally, the Company does appear to be taking credit for lost revenue prior to the filing of the conservation plan and/or for non-Company programs which may result in future conservation. The Company's request for lost revenues, both future and historical, is denied.

We note that we have allowed $93,150 in the Company's revenue requirement relating to conservation expenditures incurred during the test year. We further encourage the Company to continue with its effort to educate the public regarding the need for water conservation and the implementation of drought tolerant landscaping. Boise Water is commended for its achievements in this regard.

Inflation

Boise Water has included an adjustment for inflation in its revenue requirement. Staff notes that the Commission has consistently disallowed adjustments for future inflation as being speculative, unknown and unmeasurable.

We find:

In Order No. 25062, we disallowed the Company's inflation adjustments stating that "not only is the adjustment not known and not measurable, there is no way to determine with any degree of certainty what increased costs are due solely to inflation." Order No. 25062 at p. 16 (citing Order No. 23420, Case No. BOI-W-90-1).

The Company has not presented any new evidence or arguments supporting its request for an inflation adjustment. Consequently, it is denied.

Prospective Expenses

Staff recommends disallowing two expenses as being prospective. The first, laboratory expense, is based upon the 1994 budget plan, Staff contends.

The second, relates to Boise Water's replacement of Company-owned vehicles with leased vehicles.

In rebuttal, Boise Water provided the Commission with a letter evidencing the receipt of the leased vehicles in question.

We find:

The laboratory expense appears to have been merely budgeted as of the date of Staff's audit and, as such, is not yet known and measurable. It is disallowed.

The leased vehicle expense, as evidenced by documentation, is now known and measurable and will be allowed. We note that the asset and depreciation accounts have been adjusted appropriately to reflect this transaction.

Amortization of Intervenor Funding and Rate Case Expense

Boise Water proposes amortizing the costs of the current case and the remaining unamortized balance from prior cases over a two-year period. The Company notes that it has filed three rate cases in the past four years and that a two-year amortization is a fair reflection of the frequency with which the Company files its rate cases.

Staff proposes a five-year amortization of the costs incurred in preparing the cost-of-service study and a three-year amortization for all other intervenor funding and rate case expenses.

We find:

In Order No. 25062 issued in the last general rate case, we approved a two-year amortization for the Company's rate case and intervenor funding expenses. Order No. 25062 at p. 15. Given the growth that Boise is currently experiencing and the frequency with which Boise Water has filed its rate cases in the recent past, it appears that a two-year amortization is a more reasonable matching of costs to the time period in which they are incurred. We hereby adopt a two year amortization of all intervenor funding and rate case expenses, including the cost-of-service study.

Amount of Rate Case Expense

Boise Water claims that it incurred $296,599 in rate case expense for this proceeding. Of this amount, $32,500 relates to the cost of service study and $170,400 is the amount paid to Boise Water's affiliate, General Waterworks Management & Services Company (GWM&S Co.).

Staff argues that the mere fact that the Company has incurred a cost is not *prima facie* evidence that the cost was either reasonable or necessary. The rate case expenses incurred by the Company in this case are budget estimates, Staff contends, which have not been audited. Absent an opportunity to audit those costs, Staff argues that it is impossible to make a recommendation as to their reasonableness. Staff notes that the estimated costs in this case are far in excess of the costs incurred in Boise Water's last two rate cases. The costs allowed by the Commission in the last case were $206,750. In the prior case they were $95,905. This year's estimated rate case expense is nearly 50% more than that authorized by the Commission in the last case.

In rebuttal, Boise Water points out that it submitted a cost-of-service study in this case and that all of the rate case expenses were prudently incurred.

We find:

Because we encouraged Boise Water to submit a cost-of-service study, we believe that it is appropriate to allow the Company what appear to be reasonable costs incurred in preparing that study. The $32,500 will be allowed as a reasonable operating expense. We disallow, however, the claimed expense of $170,400 paid by Boise Water to its affiliate, GWM&S. In examining payments to affiliates we apply the rule announced by our Supreme Court in *Boise Water Corp. v. Idaho Public Utilities Commission*, 97 Idaho 832, 555 P.2d 163 (1976) and *General Telephone Company v. Idaho Public Utilities Commission*, 109 Idaho 942, 712 P.2d 643 (1986):

> Although the company may have established actual incurrence of these operating expenses, that fact alone does not establish a prima facie case of reasonableness with respect to payments to affiliates. (citations omitted). Charges arising out of intercompany relationships between affiliated companies should be scrutinized with care.

97 Idaho at 836-837.

Here, Boise Water provided only monthly billing summaries submitted by GWM&S. These summaries are lacking in detail and any meaningful review or audit of them was impossible. By proving only that the payments were actually made to the affiliate without further evidence of reasonableness, Boise Water failed to make its prima facie case for inclusion of these costs in rates. Accordingly, the $170,400 paid to GWM&S is disallowed.

We find, however, that the other claimed rate case expenses are reasonable and allow a total rate case expense of $126,199.

Operating Results Calculation

Following is the calculation of Boise Water's operating results based on the revenues and expenses approved in this Order.

Revenues		
Actual Revenues at Dec 31, 1993		14,052,004
Uncontested Adjustments		781,520
Annualize for Customer Growth Per Co.		131,782
Staff Proposed Additional Growth Adj.		149,395
Conservation Adjustment		0
Weather Normalization Adjustment		1,107,351
Total Adjusted Revenues		16,222,052
O&M Expenses		
Per Books at Dec 31, 1993		6,301,742
Uncontested Adjustments		776,884
Adjust for Actual 94 PUC Assessment		(108)
Customer Growth Adj Per Co.	16,910	
Additional Growth Adj Per Staff	20,467	37,377
Inflation Adjustment		0
Laboratory Expense		0
Leased Vehicle Expense		43,920
Normalize Intervenor Funding		18,212
Normalize Conservation Exp Per Co.	(28,997)	
Normalize Conservation Exp Per Staff Adjust	29,943	946
Uncollectible Accts Exp Adjust Per Above Rev.		3,731
1/2 of Normalized Rate Case Exp Per Co. Rebutt.	148,300	
Less 1/2 of Remaining Bal Prior Case	(85,200)	

Add 1/2 of Remaining Bal Prior Case	96,998	
Less Test Yr Actual Rate Case Amort	(83,873)	76,224
Staff Proposed Weather Normalization		87,592
Total O&M Expenses		7,346,520
Depreciation Exp at Dec 31, 1993		1,925,720
Pro forma Adjustment to Match Rate Base		687,049
Total Depreciation Exp.		2,612,769
Ad Valorum Tax at Dec 31, 1993		985,380
Staff Proposed Adj to Match Rate Base		202,506
Total Ad Valorum Tax		1,187,886
Uncontested Payroll Taxes		283,515
Net Operating Income Before Income Tax		4,791,362
State Income Taxes		69,173
Federal Income Taxes		521,409
Adjusted Net Operating Income Realized		4,200,780

IV. RATE OF RETURN

Capital Structure

Boise Water uses the capital structure of its parent, General Waterworks Corporation, which is wholly owned by GWC Corp (GWC). General Waterworks' capital structure consists of 51.93% long-term debt, 0.25% minority interest and 47.82% common equity.

Staff recommends a hypothetical capital structure which is consistent with the capital structures of GWC and United Water Resources. These two corporations recently merged. Staff's recommended capital structure consists of 52% debt, 8% minority interest and 40% common equity. In the last rate case, the Commission approved a capital structure of 50.25% debt, .29% minority and 49.46% common equity. Staff's recommended capital structure has changed because the Company's financing requirements for compliance with the SDWA are behind them and because of the merger between GWC and United Water Resources. Staff argues that its proposed capital structure is more reflective of GWC and United's actual capital structures.

The Coalition of Boise Water Customers also notes that GWC's merger with United Water Resources had an effect on the capital structure. Witness Reading notes that, according to *Value Line*, GWC's common equity ratio was 40.5% in 1993 and is expected to be 40.0% for 1994. The common equity ratio of United Water Resources was 36.0% for 1993 and is expected to be 36.5% for 1994 and 40.0% for the period 1996 through 1998. Thus, Reading notes, United Water Resources, which is purchasing GWC, has a common equity ratio four percentage points lower than the soon to be dissolved GWC. Reading recommends, therefore, that the Commission use United's 40% common equity ratio rather than the 47.82% proposed by the Company.

In rebuttal, Boise Water argues that it is a subsidiary of General Waterworks Corporation and that it obtains its financing from that entity, not GWC. The Company argues that it is inappropriate to use the capital structure of either GWC or United Water Resources.

<u>We find</u>:

Because the stock of General Waterworks Corporation is not publicly traded, we find that it is more appropriate to utilize the capital structure of the newly merged GWC and United Water Resources. Because the common equity ratio of GWC is expected to be 40% for 1994 and because United's common equity ratio is expected to approximate 40% in the near term, we find that to be a reasonable equity ratio. We also adopt Staff's debt and minority ratios of 52% and 8%, respectively.

<u>II.Cost of Capital</u>

Boise Water proposes the following cost of capital and rate of return:

	Capital Structure	Cost Rate	Weighted Cost Rate
Long-term debt	51.93%	8.94%	4.65%
Minority Interest	0.25%	5.00%	0.01%
Common Equity	47.82%	11.25%	5.38%
Overall Rate of Return	100.00%	—	10.04%

Staff recommends the following cost of capital and rate of return:

	Capital Structure	Cost Rate	Weighted Cost Rate
Long-term debt	52.00%	8.87%	4.61%
Minority Interest	8.00%	5.00%	.40%
Common Equity	40.00%	10.75%	4.30%
Overall Rate of Return	100.00%	—	9.31%

In the last general rate case, Staff recommended an overall rate of return of 9.91%. The justification for a lower overall return in this case, Staff asserts, is due to the fact that the long-term cost of debt has decreased from 9.36% in the last case to the current rate of 8.87%. Additionally, Staff calculates a slightly lower return on equity under both the comparable earnings method and the discounted cash flow method.

The Coalition of Boise Water Customers recommends a return on equity of 10.4% as it did in the Company's last general rate case. The Coalition agrees with Company testimony that there have been no significant intervening events affecting cost of capital since the last general rate case.

<u>We find</u>:

Staff's analysis supporting a return on common equity of 10.75% is convincing. The fact that Boise Water is now relatively free of the economic risks presented by the SDWA further justifies a reduction in the Company's return on common equity. There are several overriding factors, however, which convince us to leave the authorized return on equity at 11.25%.

First, our decision to normalize the effects of weather on test year consumption data arguably places the Company at somewhat greater financial risk than if some type of revenue tracker mechanism were in place. Second, it has been less than a year since we adopted a seasonal rate structure for Boise Water. Thus, our experience with the resulting effects it may have on revenues is limited. Finally, we are adopting a capital structure which is significantly different than the one approved in the last general rate case. The structure approved in this Order results in a lower overall rate of return.

Thus, we find that a return on equity of 11.25% fairly compensates the Company's shareholders for the risks they assume by investing in Boise Water.

We note that Staff proposes a cost rate of 8.87% for long-term debt. The Company originally proposed 8.94% but this was based on data as of September 30, 1994. The 8.87% rate is based on year-end data and, therefore, is the appropriate rate to use.

To summarize, Boise Water's approved capital structure and overall rate of return are as follows:

	Capital Structure	Cost Rate	Weighted Cost Rate
Long-term debt	52.0%	8.87%	4.61%
Minority Interest	8.0%	5.0%	.40%
Common Equity	40.0%	11.25%	4.50%
Overall Rate of Return	100.00%	—	9.51%

V. REVENUE REQUIREMENT

The Company's additional revenue requirement, which we find to be fair, just and reasonable, is $3,665,144 as follows:

1. Rate base	$67,218,005	
2. Rate of return	.0951	
3. Required return on rate base	6,392,432	
4. Less: Operating income	4,200,780*	
5. Operating income deficiency	2,191,652	
6. Gross-up factor	1.67232	
Revenue increase required		$3,665,144

* The operating income reflects the resulting tax consequences for every adjustment.

VI. REVENUE ALLOCATION AND RATE DESIGN

Cost of Service Study

Boise Water included a cost of service study in its rate case filing. As a result of that study, the Company has proposed that the following customer classes be adopted in this case: residential, commercial, industrial, public authority and private fire service.

Boise Water proposes two different rate designs with two different effective dates. The first rate design would take effect immediately and would remain in effect for the rest of 1994. The second design would become effective on January 1, 1995 and remain in effect indefinitely.

Under the first design, the Company proposes to eliminate the current customer allowance and to assess a customer charge based on meter size and the results of the cost-of-service study. The current winter/summer commodity rate differential of 25% is maintained but requires different customer classes to pay different commodity rates. The proposed class specific commodity rates would range from $1.175 per ccf (i.e., 100 cubic feet) for summer use for the residential class to $0.70 per ccf for winter use for the industrial class. The summer period would continue to be based on the timing of individual customer billing.

The Company's proposed second design is similar to the first design with respect to the elimination of the customer allowance, implementation of new customer charges and the introduction of commodity rate differentials between customer classes. A premium is charged, however, for water consumption in the summer when it exceeds winter usage. For all classes except residential, winter usage is each customer's actual usage in prior winter months. For residential customers "winter usage" is established for all customers at 24 ccf bi-monthly. This second rate design would also create a single summer period, with customers' usage prorated between summer and winter rates when their billing periods overlapped the two seasons. The summer/winter differential is increased from a uniform 25% to a uniform $.30, resulting in a percentage differential ranging from 41% to 60%.

Staff believes that the method of cost allocation used by the Company is a reasonable manner in which to allocate costs, but that the results of the study indicating that revenue requirement should be shifted from one customer class to another are based upon general rather than Company-specific allocation factors and assumptions. In addition, the definitions of "residential" and "commercial" classes are not based on specific water use characteristics but on the Company's existing definitions contained in its tariffs. Staff believes that uniform rates among the existing customer classes could reasonably be continued given the variability in the cost of service allocation factors and the potential for inappropriate classification of customers.

Staff recommends the implementation of a single rate design characterized by the elimination of the customer allowance without increasing the existing minimum customer charge. Staff's rate design also includes a summer/winter commodity rate differential with the first summer block based on the winter usage of each individual customer, including residential customers. Existing commodity rates are increased uniformlly to generate the additional revenue required without distinction among customer classes. As with the Company's second rate design, a fixed summer season would be established with customer bills prorated when usage for a single bill overlapped the seasons. Staff proposes a summer season of June 1 through September 30 as proposed by the Company.

Staff notes that if the Company's recommendations are adopted, changes in minimum customer charges could range from a decrease of 38.5% for customers with a ten inch meter to an increase of 22.73% for customers with a one inch meter. Staff believes that characterizing customer classes by the structure used rather than by water consumption may result in unfair treatment with water value being based on the nature of end use. Furthermore, a combination of revenue requirement shift, revenue requirement increase and rate design changes may result in unreasonably large increases in residential rates. Under the Company's proposal, commercial and public sector rates could actually decline while residential rates could increase considerably. Staff recommends, therefore, that the Company's current uniform rate structure across existing customer classes be continued.

Staff believes that only one rate design should be implemented as a result of this case, as opposed to the Company's two step approach. Staff also recommends eliminating the customer allowance without increasing the minimum bi-monthly customer charges. Staff asserts that increasing the bi-monthly minimums in conjunction with the elimination of the allowance would place an unfair burden on lower income ratepayers.

Staff also recommends that a summer/winter commodity rate differential be established in the same ratio as exists today. Staff proposes a first block in the summer charged at the winter rate and based on each individual customer's winter bi-monthly usage rather than for commercial customers only as recommended by the Company. Staff contends that this design would fairly charge all customers for their excess usage regardless of customer class.

The Coalition of Boise Water Customers criticizes Boise Water's cost-of-service study as containing subjective judgments and assumptions taken from other unidentified water systems without establishing that the characteristics of those systems are similar to

Boise Water's. Furthermore, CBWC argues that Boise Water's summer commodity rate differential has no discernable connection to the costs of Boise Water's system.

CBWC witness Reading notes that the implementation of separate irrigation systems will change the basic relationship of usage among the various customer classes. The effect that this will have, however, is unknown at this time because no serious effort to implement separate irrigation has been made.

At this time, Reading recommends against splitting Boise Water's customers into separate classes for three reasons. First, many of the inputs to the cost-of-service study are based on assumptions relating to other water systems whose characteristics may not be similar to Boise Water's. Second, the installation of separate irrigation systems will significantly alter usage patterns among different customer classes which will affect the cost of serving those various classes. Third, the industrial class, as proposed by Boise Water, contains only one customer.

The Idaho Citizens Coalition recommends that the Commission eliminate the free water in the minimum bill as proposed by Boise Water. ICC witness Power believes, however, that Boise Water should not be allowed to effectively double the fixed bi-monthly charge as it moves from a minimum bill of free water to a bi-monthly customer charge. Power asserts that the fixed charge should not be used as a dumping ground for Boise Water's fixed costs but, rather, should only collect those costs that are avoidable if a customer were to cease to take service. Power concludes that the bi-monthly customer minimum charge, given the elimination of the 1000 cubic foot allowance, should be reduced to reflect the current implicit fixed charge of about $8.50.

Power asserts that the seasonal rate differential should be continued and increased. He argues, however, that the summer block rate structure proposed by Boise Water is inappropriate because it leaves too many customers entirely within the low price block. Power suggests that the primary reason for a blocked rate structure is to protect basic consumption from higher rates and that a method of appropriately sizing the initial block for the residential class is to set it at 100% of the customer's historic average winter usage, not 130%. Finally, he contends that a block rate structure is not needed for non-residential summer rates and that seasonal rates for all consumption provides the proper price signal, reflecting higher summer costs while providing offsetting lower rates for winter usage. In any event, rate design should not insulate high load factor customers from all exposure to the higher summer rate. Thus, if the Commission decides to establish blocked summer rates for non-residential customers, Power asserts, the initial block could be set at 75% of the historical usage, not 100% as proposed by Boise Water.

We find:

We hereby adopt the following rate design for Boise Water: A $12 bi-monthly customer charge (for meter sizes 3/4 inch and smaller), the elimination of the 1000 cubic foot usage allowance, a 25% seasonal rate differential and no blocked rates nor customer class differentials at this time.

Regarding the customer charge, we find that it is unreasonable to effectively double the implicit fixed charge as proposed by the Company and Staff. Reducing the bi-monthly minimum charge to $8.50 as suggested by Power, however, would mean that none of the revenue requirement increase is assigned to the minimum charge. Given the magnitude of the increase approved in this Order, we find that to be unreasonable. Balancing many factors such as revenue requirement, conservation goals, proper price signals, cost of service, and customer expectations and equity, we find a $12.00 bi-monthly customer charge to be reasonable for customers with 3/4 inch and smaller meters. Customers with larger meters will be increased proportionately in their bi-monthly minimum charges. (See attachment A).

We continue to support the concept of a seasonal differential in rates on the basis that it sends the appropriate price signal to customers regarding the relative cost of meeting peak demand. We also note that none of the parties to this proceeding opposed the continuation of a seasonal rate differential. We find that the appropriate summer season is May 1 through September 30 for all customers with rates to be prorated for customers whose billing cycles overlap the two seasons and we caution the Company to maintain consistent billing cycles. In balancing all factors, we find it reasonable to apply a 25% premium on summer usage rates above winter rates. This yields a summer commodity rate of $1.011 per ccf and a winter rate of $0.809 per ccf.

We find that a block rate structure based on individual customer winter usage is inappropriate for several reasons. First, such a block rate design adds complexity, administrative costs, chances for billing errors and potential for customer confusion all without any proof that it will result in more equitable bills. Thus, it should be used only when necessary to accomplish specific pricing or demand objectives. We find that the proposed block rate structure has the potential to undermine our goal of summer conservation. Furthermore, the supposed equity of blocked rates is diminished by the winter rate increase that necessarily results from a lower first block rate in the summer.

The filing of Boise Water's cost-of-service study presents the first real opportunity this Commission has had to seriously consider establishing customer classes for the Company. The Company is commended for its efforts in preparing the study and proposing revenue allocation based partially on that study. Nonetheless, we share the concerns expressed by Staff and intervenors that the study is based on assumptions and data that may not be relevant to Boise Water. We are mindful that it is impossible to have class specific data until you have customer classes. We do not believe that it would be appropriate, however, to establish rate differentials among customer classes until we have had the opportunity to review class specific data. For example, we are not convinced there is justification to charge different rates for customers in single family dwellings versus customers in duplexes, or for customers engaged in a retail business versus those engaged in manufacturing. Customer classes should be based on distinct usage or cost patterns, not on type of building or nature of business. The Company is directed to sample annual, peak month and peak day water usage patterns of a cross-section of customers to determine if existing customer classifications are representative of customers within those classes. This will enable us, during the course of the next general rate case, to more fully analyze the appropriateness of establishing rate differentials among customer classes.

VII. MISCELLANEOUS

Hookup Fees

Boise Water proposes increasing the existing hookup fee for 3/4 inch and smaller meters from one that covers the cost of new supply to one that covers the cost of supply, booster pumping and storage. The Company proposes a hookup fee of $465 per customer to recover the following: $83.33 for storage, $13.89 for boosters and $250 for new supply (the per customer cost of a new well), plus a 34% tax gross-up.

Staff argues that the Company's recommendation is good in principle but will significantly over charge some customers and grossly under charge others. According to the cost of service study, and excluding taxes, the embedded cost per customer for supply and boosters is $150, while the embedded cost of storage is $57. Therefore, the difference between the hook-up fee proposed by the Company and the embedded cost recovered through existing rates is approximately $140. Thus, Staff suggests a $465 hookup charge would over recover from small, individual residential and commercial customers. Staff notes that the Company intends to charge a single hookup fee regardless of customer category, meter size or method of connection.

Staff believes that the $250 new supply cost per customer calculated by the Company is inappropriate because the cost of supply varies depending on a given customer's location. For example, recent studies indicate that ground water is very limited in southeast Boise and that groundwater supplies north of the Boise River between Broadway and Highway 55 are impractical. If the Company uses the Marden Street treatment plant to capture surface water in the future, as it suggests, the cost of providing new supply in much of the service area will increase from $250 per customer for a new well to $1,944 per customer for a water treatment plant. Thus, in areas where ground water supplies are unavailable, a hookup fee of $465 is clearly insufficient to recover the costs of serving new customers. In areas where ground water is available, the cost of new supply will actually be lower than that proposed by the Company.

Staff believes that hookup fees should be designed to take into account the following factors: [1] the location of the new customer and the cost of the most likely new resource required to serve growth in that area; [2] the method of connection, either through escrow or individual contribution, and; [3] the existence of separate irrigation systems.

Staff recommends hookup fees ranging from $2,740 for residential escrow customers in high supply cost areas to $0 for small, individual or commercial customers located in low supply cost areas. Staff also recommends hookup fee discounts for installation of separate irrigation systems because they reduce the amount of water customers will require from the Company during peak periods. Staff concedes that its hookup fee recommendations, in conjunction with existing differences based on meter size will result in a very complex fee structure and, consequently, limits its recommendations to customers with small meters.

The Coalition of Boise Water Customers recommends a service connection fee set at $2,100 for a new hookup without a separate irrigation system and $465 for new customers with separate irrigation. According to witness Reading, these two hookup fees reflect the true cost of water supplies both from wells and the treatment plant. Reading also recommends that the difference between the two fees (i.e., $1,635 per customer) be applied to the $6.8 million portion of the Marden Street treatment plant the Coalition recommends be disallowed from rate base. This would mean that when Boise Water's system has added approximately 4,200 new customers without separate irrigation systems, the $6.8 million will have been accounted for. Reading argues that his approach provides an incentive for separate irrigation. Developers who choose to build in areas where separate irrigation is unavailable, he asserts, are making a conscious decision and should be willing to accept the consequences of that decision.

The Idaho Citizens Coalition supports an increase in Boise Water's hookup fee. Witness Power expresses concern that Boise Water's hookup fee is based upon the replacement of plant at its historical cost when, in fact, new plant costs more. Power suggests that the hookup fee be raised to a level that fully funds the incremental capital costs of adding a new customer to the system that are not covered in current rates. He recommends that this Commission order Boise Water to calculate the appropriate hookup fee in this manner and impose that fee on all new customers.

In rebuttal, Company witness Booe states that the Boise City Council has voted to proceed with drafting an ordinance which would require pressurized irrigation systems in substantially all new subdivisions. Thus, Booe believes that local governments will enact legislation which should satisfy separate irrigation concerns. He expresses concern that under Staff's hookup fee proposal, only Boise Water's customers would be subjected to the higher connection costs.

Booe agrees with Staff that hookup fees should recover the difference between new supply costs and any embedded cost that rates are recovering, but admits that the Company's proposed hookup fees do not include embedded costs of water supplies as proposed by Staff. He agrees with Staff's proposal but objects to different hookup fees for different customers on several grounds. First, it would be impossible to accurately delineate on a map between high and low water supply areas. Second, it would cause confusion among customers who are being treated differently. Third, the high cost Marden Street plant is a replacement facility that serves existing customers.

Booe opposes a discounted hookup fee for customers with separate irrigation systems because those customers may still rely upon Boise Water for irrigation needs during drought years or off season when surface water is unavailable.

We find:

All parties to this case recommend an increase in Boise Water's hookup fee. The Staff proposal is intriguing and may more closely reflect cost of service on an individual basis. We find, however, that there is no feasible method of delineating between customers based on their geographical locations within the Boise Water service area. Any such delineation, by necessity, would be arbitrary and could result in neighbors paying different hookup fees. We find that, as a whole, a uniform hookup fee is fairer to all customers. We note that rate design is necessarily based on averages of individual customer costs.

According to the evidence presented, the cost of supply per customer is $250 if served by a well. This amount increases, however, to $1,944 if the customer is served from a water treatment plant. We find that a reasonable approach is to use the approximate average of these two numbers plus an amount for storage and boosters and calculate a hookup fee of $1,200. We approve a hookup fee for Boise Water in this amount for 5/8 inch and 3/4 inch meter sizes and note that it is roughly the mid-point of Staff's recommended range of $0 to $2,740. We further find that hookup fees for customers with larger meters should be increased in the same proportion. See Attachment "A". Our decision to significantly increase Boise Water's hookup fee should help to protect existing ratepayers from the costs associated with growth and to ensure that growth pays for itself.

We agree with the Coalition that a discount should be offered to new customers who are connected to separate irrigation systems. We realize that customers with separate systems may, at some point, rely on Boise Water for their irrigation needs. On the whole, however, they will contribute much less to the Company's peak than customers without separate systems. We find that $465 is a reasonable hookup fee for 3/4 inch meter, and smaller, customers connected to a separate irrigation system. Larger metered irrigation customers connected to a separate system will receive proportional discounts.

We find that offering an incentive for the development of separate irrigation systems is consistent with past Commission directives to the Company and is good public policy. When untreated surface water can be used for irrigation instead of drinking water, our scarce and valuable water resources are better utilized. In Order No. 25062, issued in Boise Water's last general rate case, we noted that: "[i]rrigation during the hot, arid summer months of southern Idaho constitutes a significant usage of water. The economic rationale for pursuing dual [separate] water systems is that the need for expensive treatment facilities, such as the Marden Street plant, may be deferred." Order No. 25062 at p. 30. As we noted earlier, it now appears that the various entities pursuing separate irrigation systems have had some success. The Company is directed to continue taking an active role in this regard.

Boise Water's Bidding Procedures

In Order No. 25062, the Commission directed Staff to investigate Boise Water's bidding practices, to determine industry standards and to present its recommendations to the Commission in the present case. Staff conducted its review and concludes that Boise Water's practices appear to be consistent with industry standards. Although Boise Water has what could be considered a closed bidding process in terms of the number of labor contractors who qualify for the sole source contract and in terms of local purchases of materials, Staff could find no evidence that costs are higher as a result of these practices.

Staff did make several recommendations: that the Commission order Boise Water to keep contracts for at least five years after they are awarded, that the Company conduct periodic reviews of local labor and material unit prices to determine the competitiveness of existing contracts, and that the Company be required to prequalify more contractors for bidding on the sole source contract now held by Owyhee Construction Company.

<u>We find</u>:

Insufficient evidence was presented in this case to substantiate suspicions that Boise Water's bidding practices are somehow unfair or discriminatory. We will adopt the recommendations of Staff regarding the retention of contracts for five years and the conducting of reviews of local labor and material unit prices. In addition, the Company is directed to prequalify more contractors for bidding on the sole source contract.

<u>Monthly Vs. Bi-monthly Billing</u>

Staff proposes that Boise Water convert to a monthly billing cycle. Staff notes that Boise Water's rates are increasing substantially and when those rates are lumped together every two months it constitutes more of a financial burden than if they are split in half, as would be the case for monthly billing. Staff witness Barker also notes that a monthly billing cycle would eliminate the perceived or actual inequities resulting from seasonal rates that start and end at different times depending on a customer's billing cycle. Staff believes that the monthly reading of meters will also allow the Company to collect better information about its customers' consumption for future use from month to month and give customers more timely information about their consumption.

Staff concedes that a monthly billing cycle will cost more than a bi-monthly billing cycle. The Company estimates that a monthly billing cycle would increase its annual expenses by $595,200 and would require additional capital expenditures of $53,090. Staff's estimate of the increased cost is $463,000 in expense and capital expenditures of $36,461. In spite of the increased costs, Staff advocates the implementation of a monthly billing cycle for the reasons stated above. Staff suggests that the Company could consider phasing in the monthly billing cycle, although it is not clear whether this would reduce its costs.

In rebuttal, Boise Water joins in Staff's proposal to convert to a monthly billing period, but states that there may be a greater need for additional labor than estimated by Staff.

<u>We find</u>:

We do not dispute the potential benefits that could be obtained from converting to a monthly billing cycle. We find, however, that the increased costs associated with the conversion do not justify the benefits. Perhaps the cost/benefit ratio will be more favorable when, and if, the Company implements a more technologically advanced meter reading system. We also note that public testimony on this issue was overwhelmingly opposed to the conversion. We find, therefore, that Boise Water should remain on a bi-monthly billing cycle.

INTERVENOR FUNDING

Applications for intervenor funding were timely filed by ICC and CBWC. ICC submits the following expenses:

Consulting Fees:		
Thomas Power	158 hours @ $70 to $5 per hour =	$11,850.00
Al Fothergill	24 hours @ $40 per hour =	960.00
Subtotal		$12,810.00
Expenses		
Thomas Power	Federal Express	$ 31.00
	Taxi	37.00
	Meals	51.25
	Telephone	32.75
	Motel	41.00
	Airfare	537.00
Subtotal		$ 730.00
Other Expenses		
	Telephone	$ 23.00
	Postage	17.00
	Printing	210.00
Subtotal		$ 250.00
Total Fees & Expenses		$13,790.00

CBWC submits the following expenses:

Legal Fees		
Composite		$20,322.00
Expert Witness Fees		
Ben Johnson Associates		$21,827.00
Expenses		
	Telephone	$ 23.75
	Telecopy Charges	156.00
	Copying	637.60
	Postage	25.28

Subtotal	$ 852.63
Total Fees & Expenses	$43,001.63

We find.

Pursuant to *Idaho Code* § 61-117A, the maximum award of intervenor funding that may be made in any one case is $25,000. We find that both ICC and CBWC materially contributed to the decision rendered by us in this case. ICC provided valuable input on Boise Water's proposed lost revenue adjustment, the Company's cost-of-service study and the appropriate hookup fee. CBWC also provided valuable evidence concerning the lost revenue adjustment as well as the Company's Marden Street treatment plant, its hookup fees, its proposed rate design, treatment of special contracts, bidding practices and its cost of capital.

In addition, we find that, in many respects, the recommendations made by ICC and CBWC differed materially from those made by the Commission Staff and that the testimony in participation of the two intervenors addressed issues of concern to all of Boise Water's customers. Finally, we find that it would constitute a significant financial hardship for the intervenors if they are not awarded the amounts of funding set forth below.

In dividing the available funding between the two intervenors, we find that it is reasonable to pay each intervenor its out-of-pocket costs. We therefore award ICC costs in the amount of $980 and CBWC costs in the amount of $852.63.

Regarding the remaining funding available, we believe that it is reasonable to fully fund ICC's requested fees in the amount of $12,810. ICC was able to cover a wide range of issues at very reasonable cost. Mr. Power's testimony on the issues of lost revenues, revenue allocation and hookup fees was detailed and well reasoned. Mr. Fothergill's modest hourly rate is very reasonable given the value of his contribution to this proceeding. CBWC also provided valuable testimony on issues of lost revenues, revenue allocation and cost of capital. We award CBWC the remaining available funding of $10,357.

Boise Water is instructed to pay these amounts within 28 days from the date of this Order. The Company is further directed that these costs, like the rate case expense, should be amortized over two years.

We would like to, again, note that although she chose not to request intervenor funding, Ms. Ullman's participation in this case was helpful to the Commission. We also express our gratitude to the public witnesses who offered their testimony at the hearing.

CONCLUSION OF LAW

The Idaho Public Utilities Commission has jurisdiction over Boise Water Corporation and its Application pursuant to the authority and power granted it under Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01000 *et seq.*

ORDER

IT IS HEREBY ORDERED that Boise Water Corporation be and hereby is authorized to file tariffs of rates and charges in compliance with the terms of this Order, to be effective for service rendered on and after three working days after receipt by this Commission.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. BI-W-93-3 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in this Case No. BI-W-93-3. 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 day of July 1994.

MARSHA H. SMITH, PRESIDENT

DEAN J. MILLER, COMMISSIONER

RALPH NELSON, COMMISSIONER

ATTEST:

Myrna J. Walters
Commission Secretary

vld/O-BOI-W-93-3.bp

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF BOISE WATER CORPORATION TO REVISE AND INCREASE ITS RATES CHARGED FOR WATER SERVICE.	))))))	**CASE NO. BOI-W-93-3** **ERRATUM NOTICE**

On July 14, 1994, IPUC Order No. 25640 was issued by this Commission. The following change should be made to that Order:

Page 10, paragraph 1, line 1

READS:

"a test year is to provide a cut off date which is necessary to establish rates in a general rate case. . . ."

SHOULD READ:

"The purpose of a test year is to provide a cut off date which is necessary to establish rates in a general rate case. . . ."

DATED at Boise, Idaho, this day of August, 1994.

CHRIS MASCHMANN - ASSISTANT COMMISSION SECRETARY

bls/O-BOIW933.ERR

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO REVISE AND INCREASE RATES AND CHARGES FOR WATER SERVICE.	**CASE NO. UWI-W-97-6** **ORDER NO. 27617**

SYNOPSIS

This is a final Order in Case No. UWI-W-97-6 determining the revenue requirement and setting interim rates for United Water Idaho Inc. (United Water; Company). By this Order, the Idaho Public Utilities Commission (Commission) authorizes United Water to increase its revenues by $1,581,989 or approximately 7.15%.

SUMMARY

On November 3, 1997, United Water filed an Application with the Commission for authority to increase its rates and charges for water service. At hearing, the Company reduced its requested revenue increase from $3,424,516 (15.47%) to $3,134,039, (14.27%).

Also at issue in this case pursuant to Commission direction are the identified service and water quality issues raised in the filings and submitted investigative reports in Case No. UWI-W-96-6 (In the Matter of the Investigation of United Water Idaho Inc and its Ability to Provide Adequate Service and Water Quality). The identified water quality problem addressed in Case No. UWI-W-96-6 was the presence of iron and/or manganese in United Water's ground water wells at levels exceeding the secondary maximum contaminant levels (SMCLs) listed in the federal Safe Drinking Water Act (SDWA). Although secondary contaminants are classified as non-health threatening, the presence of high levels of iron and manganese can result in aesthetic problems including foul odor, poor taste and discoloration.

United Water serves approximately 57,350 customers in the city of Boise and surrounding areas. The Company's sources of supply consist of the Marden Water Treatment Plant, 71 deep wells and 29 reservoirs with storage capacity of 27.4 million gallons. The combined production capacity of all wells and the treatment plant is approximately 82 million gallons per day.

United Water states that it seeks additional revenues to recover increased operating expenses and costs associated with plant additions, and to produce a fair rate of return. The Company contends that the proposed changes in its rates and charges are just and reasonable and are necessary for the Company to continue to provide adequate and reliable service to its customers.

Pursuant to Order No. 27229 issued November 20, 1997, the proposed schedule of rates and charges in Case No. UWI-W-97-6 was suspended for a period of thirty (30) days plus five (5) months from the adjusted proposed effective date of December 14, 1997. Upon a finding of good cause the suspension period was extended by the Commission in Order No. 27556 until July 1, 1998, and further extended until July 6, 1998, by Order No. 27609. Reference *Idaho Code* § 61-622.

Public hearing in this case was held in Boise, Idaho on April 22-24, 1998. The following parties appeared individually and/or by and through their respective counsel or representative:

United Water Idaho Inc.	Dean J. Miller, Esq. Walton F. Hill, Esq.
Idaho Citizens Coalition	Al Fothergill
Sharon Ullman	Pro Se
Commission Staff	Scott D. Woodbury, Esq.

The Coalition of United Water Customers, Eagle Water Company, Hidden Springs Community, LLC and Hidden Springs Water Co., although previously granted intervenor status, neither participated in nor appeared at the hearing.

At hearing, United Water proposed a rate base of $84,144,467, a reduction of $56,274 from the rate base of $84,200,741 contained in its original Application. By this Order, we make the following adjustments to that proposed rate base: (1) elimination of United Water's investment in the Northwest Pipeline,* (2) elimination of a portion of the Company's investment in Island Woods, (3)

*United Water is allowed to begin amortization of these investments with the amortization expense included in the revenue requirement. Discussed more fully later in this Order.

elimination of a portion of the Company's investment in Redwood Creek/Floating Feather,* and (4) elimination of the Company's investment in the Boise River Diversion project.* We approve a rate base for United Water of $80,424,286.

We also make numerous adjustments to the Company's proposed operating results as explained below.

We adopt a return on equity for United Water of 10.75% and an overall rate of return of 9.12%. This yields a revenue deficiency of $1,581,989, which pending conclusion of the cost of service/rate design phase of the Company's rate case, we allocate by a uniform percentage increase in rates and charges for all customers. Water usage on and after July 1, 1998 will be billed at the rates approved in this Order.

By this Order we also award Intervenor Funding to the Idaho Citizens Coalition in the amount of $6,955 and to Ms. Sharon Ullman in the amount of $3,416.22.

The Commission has reviewed the filings of record in Case No. UWI-W-97-6 including the transcript of proceedings, exhibits and post-hearing briefs. The Commission has also reviewed its Orders in Case No. EUW-W-94-1 (Eagle Area Certificate Case), UWI-W-95-2 (Garden City Exchange) and other Orders specifically referenced herein.

FINDINGS

I. Test Year

United Water proposes a historical test year ending June 30, 1997 with operating adjustments to both rate base and operating results for post test year changes. Staff and Intervenors object to some of the adjustments but no party objected to the proposed test year.

We find:

The use of a historical test year ending June 30, 1997 is reasonable for the purposes of this rate case.

II. Rate Base

United Water in its Application proposed an adjusted rate base of $84,200,741. Reference Exhibit 4, Schedule 1, p. 2. As set forth in Company rebuttal Exhibit 20, the Company proposes a restated rate base of $84,144,467. Tr. p. 1000.

The Company has agreed to and incorporated the following Staff proposed adjustments in its rebuttal rate base calculation:

- Eliminate equity gross-up AFUDC ($54,753)
- Retire Data Point computer equipment ($ 5,021)

Undisputed acquisition projects proposed for rate base treatment are $137,600 for the Company's Banbury Subdivision, and $576,740 for the Warm Springs Mesa.

Also undisputed as now being "used and useful", is the proposed rate basing of the Pierce Park/Gary Lane main installation in the amount of $252,937. This project was previously disallowed in Case Nos. BOI-W-93-1 (Order No. 25062) and BOI-W-93-3 (Order No. 25640). Tr. pp. 43-48. Expressing concern with the costs the Company was incurring in its competition with Garden City, the Commission previously ordered the Company to enter into special facilities contracts as a way of financing line extensions. The Company did not do so and now states that it became apparent following the Commission's Order that it would be impossible to fulfil the Commission's requirement as developers would seek to obtain service from Garden City rather than enter into such an agreement. Tr. pp. 44, 45. The Pierce Park main, the Company states, has now become a vital link to provide adequate service to a major service area. In 1995 the main was connected to the Hidden Hollow Reservoir in Seaman's Gulch which provides water storage for fire protection and peak demand. The main now provides direct benefit, the Company states, to approximately 5,000 customers, to customers added west of Gary Lane, to customers between Gary Lane and Pierce Park and to all customers in the west main service zone. Tr. pp. 46, 47. The Company notes that as a result of its investment not being included previously in rate base, it has already forgone approximately $190,000 of revenue. Tr. p. 48.

We find:

This is the third attempt by the Company to rate base its Pierce Park investment. Recognizing the system benefits now flowing from the Company's investment, the Commission agrees that it is now reasonable to allow a rate base addition in the requested amount, $252,937. In our prior decisions denying rate base treatment, we sought to protect the Company's customers from the then adverse and uneconomic consequences related to the Company's competition with Garden City. Those concerns have been addressed with the North State acquisition.

The following proposed adjustments in Case No. UWI-W-97-6 remain disputed:

	Amt. incl. in UWI request	Proposed Adjustment
• North State acquisition adjustment	$577,664	($577,664)
• Northwest Pipeline	$940,000	($940,000)
• Island Woods	$260,751	($ 73,400)
• Redwood Creek/Floating Feather	$890,269	($824,250)
• Three years capitalized corporate overhead	$787,735	($787,735)
	$1,882,531	($1,882,531)
• Boise River diversion (Intervenors)	$3,500	
• Book value one vehicle (Co Rebuttal)		($ 12,505)
• Transp. adj. for leased vehicles (Incl. Co. Reb. Adj.)		

North State Acquisition Adjustment

The facility and customer exchange between Garden City and United Water was approved in Case No. UWI-W-95-2. The incremental increase in rate base requested in this case to reflect that transaction is the $673,530 depreciated investment paid for the North State Area less the $95,966 exchanged Millstream facilities already in rate base. Tr. p. 614. The exchange of service areas was a discretionary decision made by the Company and municipal authorities. Tr. p. 517. In the exchange case Staff recommended that none of the Company's investment in Garden City facilities be allowed in rate base because the purchased plant was previously contributed, i.e., the assets were originally contributed to public service by developers and/or customers. In this case, Staff maintains its opposition to rate base treatment. Tr. pp. 516, 613. If the Garden City system had been owned by another public utility, as was Warm Springs Mesa, the transfer, Staff contends, would have been subject to the accounting instructions contained in the Uniform System of Accounts (USOA) adopted by the Commission. The USOA requires that assets be recorded at the original cost when first devoted to public service, that accumulated depreciation at the date of transfer also be recorded, and that any excess costs be recorded as an acquisition adjustment on the books of the purchasing utility. Inclusion of the acquisition adjustment in rate base would usually be based upon an analysis of the effect on customers. Despite the fact that the selling entity is a municipality, Staff contends that this basic principal should be adhered to. Tr. pp. 517, 518. Assessing the consequences of the exchange, Staff concludes that inclusion of the adjustment cannot be justified. Tr. pp. 518, 519. Before the exchange, the Company had 382 Millstream customers supporting a net rate base of $95,000; after the exchange they had 898 customers supporting a rate base of $673,530. Tr. pp. 966, 967.

United Water notes that in Case No. UWI-W-95-2 the Commission Staff made the same arguments for denial of rate base treatment. In that case, it states, the Company was directed by the Commission to make a calculation in its next general rate filing to show how the revenue would support the investment. The Company now argues that if the Commission's intent was to disallow the investment it could and should have done so in that case. Had the Commission done so, the Company states, it would have terminated the trade. Tr. p. 870.

Staff, utilizing a developed investment model, Exhibit 105, contends that North State revenue supports a Company investment in the Garden City exchange area of $583,164. Staff Exhibit 105 uses a customer count of 516, the 898 North State Area customers utilized by Company witness Gradilone in determining test year revenue (Exhibit No. 8, Schedule 3, pp. 29-30) minus the 382

Millstream customers given up by United Water in the exchange. Staff contends that North State revenues support very little expense or investment for the water supply needed to serve the North State area (estimated 1 MGD peak demand—Tr. p. 615). Tr. pp. 614, 676, 871. In Case No. UWI-W-95-2 the Company indicated that supply for the North State area would be met in part by purchase of water from Garden City. Exhibit 106. The purchase of water from Garden City required an interconnection investment of approximately $52,000 and is at a contract rate for all purchased water of 35¢ per 1,000 gallons. The annual revenue requirement associated with water purchases for the North State Area, Staff calculates, would support a water supply capital investment of approximately $187,000. Tr. pp. 616, 617, 801.

United Water contends that proper analysis demonstrates that North State revenue supports the exchange and any related additional investment. Tr. pp. 869, 870. The Company contends that Staff used the wrong customer count. The Company contends that additional customers have been added to the number acquired bringing the customer count to 927, calculating a total revenue supported investment of $1,568,000.

We find:

In our Order approving the underlying exchange of service areas in Case No. UWI-W-95-2, a majority of the Commission was persuaded that the exchange was in the public interest and made sense from a system and engineering planning perspective. We believed that the realignment of service areas with municipal and area of impact boundaries would serve to eliminate a disturbing pattern of checkerboard growth and uneconomic investment. Our approval also gave effect to the stated desires of the elected representatives of both Garden City and Boise City. Order No. 26562.

In its underlying Application in Case No. UWI-W-95-2, United Water in its prayer for relief requested that the Commission authorize it to include in its rate base the consideration paid to Garden City under the exchange agreement. In our Order ultimately approving the exchange, we specifically stated "United Water has failed to convince us however that we should preapprove the amount of the purchase price for rate base purposes outside of a general rate case. The Company has the burden of demonstrating the prudence of its investment in these facilities when it seeks to include them in rate base." We also noted United Water's "commitment to hold harmless the Company's other customers, both from the consequence of the rates and from the exchange transaction as a whole." Order No. 26562. Our position regarding rate base treatment was reiterated in our denial of the Company's subsequent Petition for Clarification. Order No. 26646.

United Water now states that the spirit of our prior Orders provided it with some assurance of rate base treatment and that if the Commission was inclined to deny it such treatment it should have done so then. We caution the Company that it acts at its own peril in attempting to read into a specific denial of requested relief, some assurance of future acceptance.

Staff recommends that we consider the entirety of the Company's purchase investment in the North State Area facilities to be an acquisition premium and deny rate base treatment of same. The record in this case and the related acquisition case clearly support a finding that the facilities transferred to United Water were originally contributed to Garden City rather than purchased. It therefore follows that the purchase price paid by United Water was at a cost which was in excess of the original cost of the property when first devoted to the public service, less applicable accrued depreciation. It is therefore, reasonable to regard the Company's purchase price as an acquisition adjustment. The Company recommends rate base treatment of its investment, yet as we noted in the acquisition case, the Company acknowledges that its proposal is contrary to established regulatory policy. Order No. 26646.

As a regulatory rule or policy, the position advanced by Staff in this case regarding presumption of contributed capital and accounting treatment is generally accepted. We find, however, that it is also the starting point from which we entertain arguments for exception or different treatment. Each acquisition is reviewed on its own merit. Analysis of the acquisition cost regarding rate base treatment permits an assessment by this Commission of the benefits flowing from the transaction and the impact on the Company's other customers. An acquisition adjustment is one of several incentive mechanisms that this Commission can use to encourage water industry restructuring. In addition to the stated public policy benefits announced in our approval of the acquisition, we find that the acquisition brings efficiencies of service and improved operations, management and technological expertise to the North State customers. We also find in reviewing the cases related to the phase-in of rates for the North State area that the exchange and related facility improvements have enhanced water pressure and water quality for North State customers. We find that the transaction provides both present and future benefit to affected customers, municipal planning authorities, and United Water itself. Based on our review of the record in this case and the underlying certificate case, we find it reasonable to conclude that the price ultimately paid by United

Water to Garden City was the result of arms length negotiation and was a fair and reasonable price. We are satisfied that the revenue generated by the North State customers supports the exchange and related investment. For all these stated reasons, we find it reasonable to look beyond the contributed nature of the acquired facilities and approve an increase in rate base in the amount of $577,664 for the North State Area investment.

Northwest Pipeline

United Water calculates that the main service level, which includes the downtown Boise area and the area northwest of the downtown area, has a supply capacity deficiency of six (6) million gallons per day (MGD), a deficiency that requires new water supply facilities. Exhibit 17. To reduce this deficiency, the Company has constructed a 3.5 mile pipeline at a cost of $940,000 to connect the Hidden Hollow storage reservoir in Seaman's Gulch with the Floating Feather/Redwood Creek water system west of Eagle, a system with a present supply surplus of 2-3 million gallons per day. Tr. pp. 41, 617. Test well drilling in 1997 to locate a new water supply in the State Street Area resulted in the discovery that both the water quantity and quality necessary to serve customers in the main service level was not available. This lack of supply, the Company states, hampered its ability in the summer and fall of 1997 to fill its Hidden Hollow reservoir. To prevent further service-related problems, the Company stated it was faced with the necessity of locating, developing and delivering water to the Hidden Hollow reservoir before peak usage in 1998. To avoid further unsuccessful attempts at locating a supply, the Company decided to tap into a source of known quantity and quality. Tr. p. 41.

Staff contends that the constructed pipeline was not needed, that there was no urgency, that the supply deficiency was no greater in 1997 than in past years (Exhibit 107; Tr. p. 618); that with a planned 8 MGD Marden treatment plant expansion scheduled to come on line in May 1999, the deficiency is short term (Tr. pp. 630, 826-828); that the Company failed to utilize during 1997 peak requirements other supply resources available to it: e.g., the Swift No. 1, which the Company was not using because of aesthetic water quality problems, (Tr. p. 813); Garden City contract supply rights (Tr. pp. 819-824); and available supply from other service levels (Tr. p. 621). In addition, Staff notes that other main service level wells completed since 1997 have been brought on line and are now available—27th Street Well, Tr. pp. 653, 819; also Swift No. 3. Supplies less costly than the pipeline, Staff contends, could also have been constructed (the Company previously estimated that new supply could be developed for approximately $300,000/MGD—Tr. pp. 617, 654). Staff questioned the Company about parallels between the Southeast Boise Water Supply Project pipeline, which the Company now contends was developed as a temporary water supply, and the northwest pipeline. Staff notes that current and future development and related water supply contracts in the Eagle area may require the Redwood Creek/Floating Feather water supplies (Tr. pp. 618, 619). Staff also queried why the Company would not have considered bridging what Staff perceives to be a short-term supply deficit with conservation measures, i.e., alternate day sprinkling. Tr. pp. 809, 810, 959, 960-962. Finally, Staff notes that a lengthy distribution pipeline constructed ahead of development places a substantial portion of the cost of new development on the backs of existing ratepayers rather than through developer contributions, as the line extension rules would otherwise require. Tr. pp. 620, 678, 679.

Coincident to the need for new supply in the main service level, Staff notes, construction of the northwest pipeline will make nearly $850,000 worth of investment in the Eagle area used and useful, will provide reservoir back up and emergency fire protection to the Eagle municipal water system and will make lower cost service available to a large undeveloped area that would simply not be possible without the pipeline. However, none of these reasons, Staff states, should be regarded as justification for making existing customers pay for the pipeline project through rates. Tr. p. 622.

The Company does not agree with Staff's contention that the supply capacity deficiency is short term. Tr. pp. 959-960. It is not unreasonable, the Company contends, to have a system supply capability greater than demand. The nature of the beast, it states, is that wells are mechanical and there are going to be times when they are out of service. Tr. p. 960. It is also not unreasonable, the Company admits, to ask customers to conserve water—indeed, it did that in 1994. Tr. p. 961. United Water by way of rebuttal introduced Exhibit 31 to show supply and design constraints in the United Water system. Tr. pp. 841-846. One critical area of constraint the Company contends is Collister Road west to Horseshoe Bend Road and between State Street and Hill Road. Tr. p. 843. Prior to construction of the northwest pipeline, the Company states there were limitations on the ability of the distribution system to transmit water adequately to the Hidden Hollow Reservoir. Tr. p. 844. The import-export capability of the distribution system, the ability to move water from one pressure level to another, is also limited, the Company states, to 6 - 7 million gallons per day. Tr. p. 846. The Company questions, because of distribution losses, whether the Marden expansion will be able to beneficially impact identified main service level areas of need. Tr. p. 845. The Company disputes any obligation to provide the City of Eagle with any waters other than fire flow. Tr. pp. 962-964.

The Company contends that Swift Well No. 1 should not have been listed by the Company in response to a Staff production request as a source of supply in the main service level west of 36th Street. It should instead have been noted that it was to be held in reserve for emergency conditions, i.e., when the Company would otherwise be faced with restricting or curtailing water usage. Tr. pp. 813, 814. The Company presently plans to use Swift No. 1 as an aquifer storage and recovery (ASR) project, injecting high quality water into the aquifier and pumping it out during demand periods. It expects the ASR project to be fully operational by summer year 2000. Tr. p. 817.

We find:

The Company has failed to persuasively demonstrate that its decision to construct a pipeline was for its customers a prudent decision, that it was the best economic and planning alternative available to it or that it was even needed at this time. It is undisputed that by completing the pipeline the Company is able to transport surplus water from the Eagle area to Hidden Hollow Reservoir; that its ability to do so provides it with an additional resource to reduce or mitigate capacity deficiencies in the main service level; that it provides a benefit to customers outside the Eagle area; and that it is otherwise "used and useful." It is also undisputed that the Floating Feather well waters will provide the Company with a supply of high quality water for its main service level, water without elevated levels of iron and/or manganese.

Despite the foregoing findings, our decision in this matter is directed by the Company's failure to avail itself of what we find to be other, more economic alternatives. We refer of course to the Company's decision to forego contractual rights in its Garden City supply contract; to forego the use during critical periods of peak demand of its Swift No. 1 well; to ignore the additional main service level well capacity brought on line since 1997, capacity additions which most certainly had to have been planned; to forego the full utilization of water transport capability between service levels; to fully recognize that the main service level supply deficiency would be mitigated to a large degree by the planned 1999 Marden expansion; to forego the planned use of demand conservation measures (e.g., alternate day sprinkling) to bridge what can be reasonably perceived to be a short-term supply deficiency.

Although the Commission will not allow the investment to be rate based at this time, we will allow the Company to recover amortization of its investment in recognition that it is used. Embedded in the Company's case is $18,800 of depreciation expense that we will allow to remain for this purpose.

Redwood Creek/Floating Feather

The service to Redwood Creek was authorized by the Commission in the Company's Eagle area certificate case. Reference Case No. EUW-W-94-1. The source capacity for the area is 5.0 MGD. Currently usage for domestic and fire protection is 2.17 MGD. The Redwood Creek project is a combination of purchased existing facilities and new facilities constructed by the Company. Tr. p. 611.

Utilizing a developed investment model (Exhibit 104) and Company derived input (27 customers; $457 annual revenue per customer), Staff determined that of the $890,269 investment requested in rate base by the Company for the Redwood Creek/Floating Feather acquisition, only $66,019 of investment is supported by related revenue. Tr. p. 613. Staff therefore recommends that $824,250 of the requested net rate base increase for Redwood Creek be disallowed. Tr. p. 613.

United Water in rebuttal contends that it is reasonable to use actual or projected rather than test year customer numbers and revenue in justifying the rate basing of its investment expense. Exhibit 15, Tr. pp. 854-856. Utilizing current customer numbers (52) and revenue ($409 annual revenue per customer) the Company contends that $114,000 of investment is supported. United Water contends however that Staff's model is inappropriate for determining rate base in the Redwood Creek/ Floating Feather area. The Company recommends inclusion of the entire $890,269 based on its planning determination that the surplus water was needed to supply customer demand in the Company's main service level, and its construction of a pipeline to transport the water. The investment, it states, is now linked to the Company's integrated system, and is now used and useful. Tr. pp. 856, 858. Staff challenges the prudence of the Company's decision to construct the pipeline to connect the Redwood Creek/Floating Feather area to the Company's main service level.

We find:

In assessing this investment, we rely on the Company's prior assurances in Case No. EUW-W-94-1 that it would not be asking its existing customers to subsidize its Eagle area investment. We also find that Staff's investment model is acceptable for calculating the amount of investment supported by revenue and the amount of related subsidy.

The Company contends that because it has constructed three and one-half miles of main line and connected the heretofore isolated Redwood Creek/Floating Feather System with its greater integrated water system, that its entire investment in the Eagle area facilities has now been made "used and useful" and should be rate based. As explained above, the Commission has denied ratebase treatment for the main line. Despite the physical connections of Redwood Creek with the Floating Feather Well, it is clear that the pipeline was intended to primarily access water supply provided by the Floating Feather well. Accordingly, we find it reasonable for rate base purposes to separate the Floating Feather well from the rest of the Company's Redwood Creek investment.

Beyond that however, there is reason to question the Company's pipeline investment, its timing and its reasonableness as discussed above. Based on our analysis and decision to deny rate base treatment of the pipeline, we find that Staff's investment model analysis is appropriate for Redwood Creek/Floating Feather.

Included in the Company's depreciation expense is $27,646 related to the Redwood Creek/Floating Feather well investments. Of this amount, $11,927 is related to the Floating Feather well. We will allow the $11,927 expense to remain in the revenue requirement calculation to provide for amortization of the Company's investment in the well. We do this in recognition of the fact that the Floating Feather well is presently being used as a source supply for the northwest pipeline.

Island Woods

Service to Island Woods was authorized by the Commission in the Company's Eagle area certificate case. Reference Case No. EUW-W-94-1, Order No. 26337. Island Woods is an independent water system that is not connected to the Company's larger distribution system. Tr. p. 43. United Water paid $276,150 and $103,850 respectively for Island Woods supply and distribution facilities. Tr. p. 42. The source capacity of Island Woods wells is 2.6 million gallons per day or 1,800 gallons per minute. Current demand requirements for source are 62% of current capacity, 1,000 gallons per minute for fire flow and approximately 120 gallons per minute for peak hour domestic service. Tr. p. 43. The Company proposes including its entire Island Woods investment in distribution in rate base, reasoning that with 81 Island Woods customers in September 1997 the Company's Line Extension Rule in effect at that time would have supported an investment of $113,400. Based on its demand analysis, the Company proposes including only 62% of its supply investment in rate base, with the remainder being placed in plant held for future use. Tr. p. 43.

Utilizing a developed investment model (Exhibit No. 103) and Company derived input (84 customers; $435 annual revenue per customer) Staff determined that of the $260,751 requested for rate base by the Company for the Island Woods water system, only $187,351 of investment is supported by related revenue. Tr. p. 613. As described by Staff, the model determines the incremental increase in revenue requirement due to increased operating expenses, taxes and depreciation expense. The increased revenue requirement is then compared to the incremental increase in annual revenue generated from the new customers to determine if the Company will earn its authorized return on investment. If insufficient new revenue is generated, then, Staff contends, investment must be reduced or the general body of ratepayers will be required to subsidize the acquisition. Staff therefore recommends that $73,400 of the requested net rate base increase for Island Woods be disallowed. Tr. p. 613.

United Water in rebuttal contends that it is reasonable to use actual or projected rather than test year customer numbers and revenue in justifying rate basing its investment expense. Exhibit 14; Tr. pp. 852, 948, 949. With projected numbers the Company argues that ratebasing its entire requested investment is justified. Utilizing current customer numbers (90) and revenue ($491 annual revenue per customer) the Company contends that $230,800 of investment is supported. The Company proposes no pro forma adjustment to either its customer numbers or revenue numbers in this case. Tr. pp. 643, 950.

The Company further contends that rather than look at Company acquisitions on a stand-alone basis regarding any subsidy that may be required, the Commission should consider the overall materiality of the subsidy or determine in light of other benefits that may be associated with the transaction, that some immaterial amount of subsidy might be acceptable. Tr. pp. 637, 638.

We find:

In our final Order No. 26337 in Case No. EUW-W-94-1, the Commission approved the Company's requested certificate. Our recitation of facts in that Order reflects the following language: Commission Staff, based on its analysis of project economics, area growth and projected revenue, characterized United Water's investment in the Eagle area as speculative. United Water admitted that Eagle area revenue in the near term might be insufficient to cover Eagle area investment. Existing UWI customers, United Water nevertheless assured the Commission, would not be asked to subsidize the new customers in the Eagle area.

In our findings, we stated, "A regulated water utility is at risk in extending into, acquiring property and investing in non-contiguous areas without a prior certificate." Order No. 26337.

Despite its prior assurances to the Commission and its customers, the Company is now before us arguing that we should not consider the customer numbers used by the Company in its test year revenue calculations but instead higher actual or projected numbers to assess the investment supported by revenue; the Company also asks us to consider whether some immaterial amount of subsidy might be acceptable. We cannot adopt the Company's proposal. Our previous approval was done in reliance on Company assurances that the costs of the acquisition would not adversely impact other customers. We also find that we must be consistent in the use of customer numbers and revenues and expenses to avoid unreasonable mismatches. We find that Staff's investment model presents an acceptable methodology for determining revenue supported investment. $73,400 is not an immaterial amount. We accept Staff's proposed adjustment and approve rate basing of $187,351 of the Company's Island Woods investment in this proceeding.

Capitalized Corporate Overhead.

Because of a perceived potential for interaffiliate subsidies, Staff proposes to remove capitalized overhead costs charged to construction projects for a three-year period ending June 1997 for fees and expenses charged to United Water Idaho by United Water Resources and the M&S Company. Reference Exhibit 118, pp. 1, 2; Tr. pp. 520, 521.

The capitalized overhead adjustments in this case, the Company states, are engineering costs incurred through the M&S Company on behalf of the customers of United Water Idaho. Tr. p. 992. United Water points out that Staff's adjustment would effectively eliminate overheads that were already approved by the Commission in the 96-3 case, which was based on a test year of 1995 (Tr. p. 569), and would deny the Company an opportunity to earn a return on the value of services capitalized in this case. Tr. p. 570. Referring to Staff Exhibit 118, the Company notes that since 1994 the rate of overhead accrual has actually gone down, that overheads were accruing at a rate of 3.5% through the 1994 period, 3.4% in the 1995 period and from 1996 to present have ranged from 2.4% and now are at about 2.9%. Tr. pp. 572, 573.

We find:

The Company's argument in this instance is persuasive. Staff was unable to provide any evidence of interaffiliate subsidies charged to United Water. Although it appears that the overheads are percentage loading and not based on time, it is also clear that affiliate services were provided to Idaho. The established record does not support the Staff proposed disallowance.

Boise River Intake

The Boise River intake project is comprised of 2900 feet of 30 inch discharge main through the Surprise Valley Canyon wall cut for Highway 21 and a river diversion structure. The purpose of the intake/transmission main is to supply Boise River water to a future service water treatment plant. The Company anticipates that diversion waters will be required to meet projected southeast Boise demand in year 2005. The southeast Boise area lacks adequate ground water and has been designated a Ground Water Management Area. It is also an area targeted for significant growth (residential, commercial and industrial) in Boise City's Comprehensive Plan and other planning documents, with current and future customer growth projections exceeding 8% per year. Tr. pp. 25-31.

To meet future demand in southeast Boise the Company explored four potential sources of supply: (1) wells within the area (no available supply), (2) wells outside the area (Southeast Boise Water Supply Project limited by capacity and time), (3) the Marden water treatment plant (design capacity and transmission constraints), and (4) a new water treatment plant. Tr. pp. 31-33. Based on its analysis, the Company concluded that a new water treatment plant, located in the vicinity of the Columbia bench was the only viable alternative source of supply for the area. The most feasible site for a river intake and pumping station was determined to be the site of an existing pumping station used by the Harris family for irrigation. Tr. pp. 33-35.

The Company's decision to go forward with the river intake project at this time, it states, was based on a number of factors: (1) opportunity to utilize an existing diversion, (2) avoidance of perceived legal challenges to a new diversion, (3) opportunity to join and share construction costs with Micron Technology, J.R. Simplot Company and Surprise Valley L'td Partnership, who independently were working on a proposal to upgrade the existing river diversion, (4) timing of construction dictated by forces over which United Water did not have control—Micron/Surprise Valley needed water by spring of '98; mandate of Idaho Department of Transportation and (5) its obligation to serve. Tr. pp. 35-38.

The Company states that it saw no other viable alternative for future water service to the southeast Boise area. If the structure was not completed at this time, it states, it would have been impossible to install facilities at a later date. Tr. p. 39. Recognizing that there is no immediate need for the diversion waters to meet demand, the Company notes that the facilities constructed are only those which could not be delayed until the treatment plant is built—i.e., no pumps, electrical equipment or other mechanical equipment have been installed. Tr. pp. 37, 38.

Except upon a finding of an "extreme emergency", the Commission is prohibited under *Idaho Code* § 61-502A from setting rates for any utility that grant a return on construction work in progress (CWIP) or property held for future use which is not currently used and useful in providing utility service. United Water contends that its investment in this instance was incurred in response to an "extreme emergency" and "undertaken in response to a mandate from government to either install the facilities now or be precluded from ever installing them." The Company did concede that "the only written document that it has from the Idaho Department of Transportation is a permit which said that this line construction will be done prior to paving of the roadway." Tr. p. 973. As represented, the Company perceived that it had no viable alternative and therefore concluded that it had no choice but to make the investment now. Tr. pp. 39, 81. The Company denies that its decision to construct was based merely on its opportunity to share construction costs. Tr. p. 38. The Company maintains that it is reasonable that existing customers share in the cost of planning and development; that the length of time to develop a new source of surface supply is five to seven years. Tr. pp. 880, 881, 948. It thus requests that its investment be included in rate base. The annual revenue requirement associated with its investment is approximately $306,000. Tr. p. 624.

The Idaho Citizens Coalition opposes including the Boise River diversion in rate base until it is "used and useful." Reference *Idaho Code* § 61-502A. The installed facilities, it states, are not providing water service to customers, there are no pumps installed, there is no related water treatment plant, indeed the Company does not even have water rights that would allow it to operate the diversion. Tr. p. 691. The Company, the Coalition states, has built ahead of need and actual use. This is a plant designed for future use. Tr. p. 692. The Coalition maintains that a lower cost business opportunity does not constitute an "extreme emergency"; that United Water assured the City of Boise that it would not seek to include the project in rate base until it was fully used and useful (reference Exhibit No. 110); that intergenerational equity demands that current customers not be required to pay for facilities that will not be required until the year 2005 (see Tr. p. 878); and that normal market conditions would impose a similar discipline on competitive business. Tr. pp. 693-695.

We find:

The Company in this case presents us with no physical evidence or documentation of a "mandate from government" of such a nature that we could find the "extreme emergency" exception to *Idaho Code* § 61-502(a) exists. Its professed belief that it was subject to such a mandate and that it would have been precluded in the future from **ever** installing facilities at the Highway 21 cut is not supported by persuasive evidence. Based on Company demand forecasts there will be no need for the facilities until the year 2005. This is a pipe that goes nowhere and is not hooked up to anything. The Company's investment is not presently "used and useful." Rate basing is therefore prohibited under *Idaho Code* § 61-502(A).

We find, however, that the Company's decision to install facilities now may be of future benefit to its customers. We do not wish to discourage the Company from making decisions that make good business sense. Certainly, in this instance, the opportunity to share construction costs and utilize an existing diversion with others was an incentive to action. We, therefore, find it reasonable to allow amortization of the Company's present investment in the Boise River intake project so that this investment will be recovered. We note that the Company's calculation of depreciation expense in this case includes an allowance for this project, of $37,651. That expense allowance is approved in this Order to provide for the recovery of this investment.

Transportation Adjustment for Leased Vehicles
Restore Book Value One Vehicle to Rate Base

Staff proposes an adjustment to make a correction for a change in the Company's plans for replacing a vehicle and eliminate some capitalized costs of the Company's vehicle leasing program. Tr. p. 515. The adjustment removes from rate base the extra costs the Company incurred through its vehicle leasing program. Tr. pp. 522, 526, 527; Exhibit 119, p. 1. By this adjustment, Staff continues to challenge the Company's switch from ownership of its vehicle fleet to leasing, the Company's failure to present a persuasive cost/benefit analysis of lease versus own, and to articulate and credit customers with offsetting savings. Reference Order No. 26671, UWI-W-96-3; Tr. pp. 522-524. Company assumptions regarding vehicle residual values, Staff contends, are artificially low and adjusted to favor leasing. The actual experience of UWI over the last few years, Staff maintains, demonstrates unequivocally that the residual values are wrong and that leasing is more costly to the Company. Tr. pp. 524, 525; Exhibit 119, p. 2; Exhibit 118.

The methodology employed by the Company in its cost/benefit analysis in this case (Exhibit 22) is essentially the same methodology presented in UWI-W-96-3. Tr. p. 1079. United Water interprets the Commission Order in Case No. UWI-W-96-3 as generally accepting the Company's cost benefit analysis. Tr. pp. 104-106, 1081. The Company's analysis, it states, has been presented and accepted by the majority of the states in which United Water operates. The Company disputes Staff's continuing contention that its cost/benefit analysis is flawed and superficial, arguing rather that it is instead well thought out and comprehensive. Tr. pp. 1008-1010; Exhibits 22, 23. The Company further disputes Staff's contention that its vehicle residual values have been adjusted to favor leasing and contends that Staff analysis is not based on utility vehicles, which experience extremely hard service lives. Tr. p. 1010.

We find:

Pursuant to a policy that seeks to take advantage of economies of scale, the Company continues its transition from vehicle ownership to leasing. We recognize that cost savings may be achieved with a uniform program in multiple states of operation. We are satisfied that the attendant costs and benefits were considered and weighed by the Company. Owning and leasing are both reasonable and viable alternatives. Although the related expenses may vary, we find that the

Company is not legally constrained to choose the least cost alternative. The expense incurred should be authorized if it is determined to be otherwise reasonable.

In this case, Staff disagrees with the Company's projected residual values contending that they do not comport with the Company's actual resale experience. We are seemingly being asked to judge projections and estimates under a leasing scenario with records developed under an ownership scenario, and to then make a decision as if the own versus lease cost equation can be simply reduced to the amount realized on resale. We think not. The Company's proposed lease expense and related rate base adjustment has not been shown to be unreasonable. We reject Staff's proposed leasing adjustment. We approve restoring the $3,500 book value of one vehicle to rate base.

Rate Base Calculations

Following are the calculations for United Water's approved rate base:

Plant in Service		
Per Company Ex. No. 20, Page 1		$137,099,238
Less Northwest Pipeline		(940,000)
Less Portion of Island Woods	(73,400)	
Less Portion of Redwood Creek		(824,250)
Less Boise River Diversion Project		(1,882,531)
Adjusted Total Plant in Service		$133,379,057
Less: (Per Company Ex. No. 20, Page 1)		
Accumulated Depreciation		(27,573,584)
Customer Advances for Construction		(2,112,097)
Contributions in Aid of Construction		(19,725,787)
Utility Plant Acquisition Adjustment		(208,028)
Accumulated Deferred Income Taxes		(5,384,478)
Net Adjustment for Island Woods (Co proposal)		(99,476)
Pre 1971 Investment Tax Credits		(22,594)
Add: (From Co. Ex. No. 20, Page 1)		
Deferred Charges		281,195
Working Capital		1,890,078
		$80,424,286

III Operating Results

As reflected in its initial Application the increase in annual revenue requested by the Company was $3,424,516 or 15.47%. As set forth in Company rebuttal Exhibit 20 a revised annual revenue increase of $3,134,039 or 14.27% is requested. Tr. pp. 1000, 1001.

The Company has agreed to and incorporated into its rebuttal Exh. 20 results of operations, the following Staff proposed adjustments to operating expense:

• Ad valorem adjustment—(Co. Post Hng Exh 33)	($13,265)*
• Correct info collection rule (SDWA) test schedule	($ 2,810)
• Correct purchase water double count	($ 1,800)
• Correct employee health insurance	$ 9,634
• Correct employee thrift plan	($ 446)
• Correct telemetry expense	($ 7,123)

The Commission Staff has further agreed to reverse a proposed Exhibit 115, Column K ($3,947) payroll tax adjustment, as Staff agrees that it is a duplication of an adjustment already made by the Company. Tr. pp. 104, 1021-1023.

Also agreed to is a ($168) adjustment to correct the Company's PUC annual regulatory fee assessment to the 1998 actual amount. Tr. p. 157. The pro forma annual IPUC assessment expense is $51,807. We find the substitution of actual expense for estimated expense to be reasonable.

On May 18, 1998, the Company submitted a second amended Exhibit No. 5 Schedule 1, p. 7 setting forth amended power cost calculations based on test year usage and Idaho Power Company rates as of 5/16/98. Reference Order No. 27516. The related corrected adjustment increases test year expense by $74,484, rather than the decrease of $31,807 originally proposed and included in the Company's rebuttal Exh. 20 operating expenses. The effect of the amended calculation is an increase of $106,291 to the operating expenses reflected in Exh. 20. This adjustment affects the operating ratio adjustment calculation. The pro forma annual purchased power cost is $1,110,698. We find the use of current electric rates in the Company's power cost calculations to be reasonable.

---

*Corrected adjustment number based on the actual 1998 market value appraisal of $70,956,346

Eliminate Depreciation Expense Equity Gross-Up

Staff made an adjustment to rate base to eliminate the capitalized AFUDC gross up. The Company agreed with the adjustment and reflected the $54,753 rate base adjustment in rebuttal Exh. 20. Tr. p. 1039. The depreciation expense associated with the amount removed from rate base must also be removed from expenses. The depreciation expense adjustment is $1,617 ($80,857 rate base, 50 year life).

We Find:

Staff's uncontested $1,617 adjustment to depreciation expense is proper and makes the capitalized AFUDC gross-up revenue neutral as provided by FAS 109. (Exh. No. 26).

Adjust Transportation Expenses

United Water's transportation expense reflects 43 leased vehicles with an average lease term of approximately 3.5 years. This proposed adjustment carries through Staff's correction related to the Company's switch from ownership of its vehicle fleet to leasing, proposes to eliminate lease expense in excess of historical expense with ownership, and reduces the Company's proposed level of operating lease expense from $286,800 to $171,402. Exh. 119 p.1; Tr. pp. 527, 529.

The Company disputes Staff's criticism of its lease versus own cost/benefit analysis and believes that the Staff proposed 40.24% reduction in expense allowance for leased vehicles is unreasonable. Tr. p. 1010. Staff's seeming reliance on the fact that the Company's transportation overhead rate has increased from 6.5% to 11.5% from 1994 to 1997 as an indication that leasing is more expensive than vehicle ownership, the Company states, is erroneous in that the Staff ignores the other side of the equation, the fact that owned vehicles also require a return on rate base and the associated income tax impact. Tr. p. 1011. See additional Company analysis, Exhibit 24, Tr. pp. 1012-1018. On rebuttal the Company proposed a $21,400 reduction in the level of transportation expense requested based on expected lease residual values flowing back to the Company on approximately 12 vehicles/yr from American Leasing Corp. Tr. pp. 1008, 1018; Exh. 20, p. 3.

We Find:

For reasons expressed in our related rate base discussion above, we find vehicle ownership and leasing are both viable options available to the Company. We find the Company's decision to switch from vehicle ownership to leasing to be a reasonable business choice. Staff has not demonstrated that the Company's transportation and vehicle lease expenses are unreasonable. The Company on rebuttal proposes a $21,400 reduction in lease expense to reflect projections that its leasing company will realize 20% more for the Company's vehicles than the residual value utilized in calculating the lease payment. We approve the adjusted expense level of $265,400.

Adjust PUC Rate Case Expense

Under the Company's proposal, test year expense is increased by \$115,654 for the amortization of current rate case expense and the unamortized balance of two prior proceedings, the connection fee case (UWI-W-96-4) and the water quality (UWI-W-96-6) investigation. Exhibit 5, Schedule 1, p. 18. The Company estimates that the current rate case will cost approximately \$300,000 to which \$36,813, the unamortized balances from the prior proceedings, is added to reflect a total unamortized balance of \$336,813. The \$336,813 is divided by two years to reflect an annual amortization of \$168,407. Deducting test year expense of \$52,753 produces an adjustment of \$115,654. Tr. p. 124.

Staff as detailed in Exhibit 120 adjusts UWI's estimated rate case expense to split these costs between customers and shareholders. Staff further adjusted expenses for other PUC cases to amortize these non-recurring charges over a five (5) year period rather than two (2) as requested by the Company. Tr. pp. 530-532.

The Company agrees on rebuttal that a five-year amortization period for the deferred regulatory expense related to the connection fee and water quality cases is reasonable due to the non-recurring nature of such cases. Tr. p. 1023. The Company did not however make any adjustment in its rebuttal exhibits to recognize its agreement. The Company notes that through its efforts to control costs, its current estimated rate case expense is lower than costs actually incurred in its last general rate filing. Tr. pp. 1024, 1025. Company witness Healy disputes Staff's contention that a double counting of his rate case costs has occurred, stating that the costs of his time related to rate case functions is not included in the deferred rate case cost, it is only reflected in the Company's O&M expense. Tr. p. 1025.

The Company notes that during the discovery process it provided Staff and intervenor Sharon Ullman with a break down of estimated rate case expense and also copies of actual invoices, bills and contracts supporting actual costs received to date. Tr. p. 1027. Neither Staff nor Ms. Ullman, the Company states provided any analysis or reasoning supporting their conclusion that rate case expense was too high. Tr. pp. 1027-1031.

We find:

The Commission finds the Company's estimated general rate case expense to be reasonable. We understand said expense to include both the revenue requirement and cost of service/rate design phases. We understand that embedded in its estimate are attorney fees and intervenor funding. We find no justification for requiring the Company to split rate case expense between customers and shareholders. United Water and Staff propose amortizing the costs of the current rate case over a two year period. We find that a three year amortization for rate case expense provides a more responsible matching of costs to the time period in which they are incurred. We accept the reasonableness of a five year amortization period for the deferred regulatory expense related to the make whole, connection fee and water quality cases, $36,813. We further allow the Company total general rate case expense of $300,000 amortized over three years. The following table reflects the rate case expense adjustment of ($61,044) to the pro forma test year.

United Water Idaho
Staff Adjustment to
Rate Case Expense Amortization

1. Current Rate Case Expense (Ex 5, Sch 1, Pg 18)	$300,000	
2. Ratio of Expense to customers	100.00%	
3. Expense to be passed through to customers	$300,00	
4. Amortization period in years	3	
5. Annual Amortization Expense		$100,000
6. Other Case Expenses (Ex 5, Sch 1, Pg 18)	$36,813	
7. Amortization period in years	5	
8. Annual Amortization Expense		7,363
9. Total Amortization Expense		$107,362.6
10. Test Year Amortization Expense (Ex 5, Sch 1, Pg 18)		52,753
11. Required Adjustment to Test Year		$54,609.6
12. Company proposed Adjustment (Ex 5, Sch 1, Pg 18)		115,654
13. **Adjustment to Company's Performa test year**		**($61,044)**

Adjust Operating Ratio Adjustment

This Staff proposed adjustment as detailed in Exhibit 121 is intended to synchronize expenses related to the effects of customer growth and weather with the Company's variable operating expenses that are sensitive to these changes. Tr. pp. 532, 533.

The Company agrees with Staff's methodology, except for one point. Staff, it contends, has substituted the level of transportation expense on line 3, column b of Exhibit 121, thus lowering the ratio of growth related expenses to revenue. The calculation of this adjustment, the Company contends, cannot be made until a level of transportation expense is decided. Tr. pp. 1032, 1033.

We find:

Having made our decisions in this Order regarding the authorized level of transportation expense and power supply cost, a recalculation of the operating ratio adjustment under the agreed methodology results in a decrease in Company operating expenses, as reflected in Company rebuttal Exh. 20, in the amount of ($739).

Reverse Adjustment for M&S Fees

Services provided to United Water Idaho from United Water Management and Services (M&S) are provided pursuant to an agreement between the companies. Test period level of Management and Service charges were $868,565. The Company states, however, that due to recording variations, this level is not representative of the annual expense. The 1997 charge which contains seven months actual data and five months projected data, indicates a pro forma level of Management and Service charges of $948,643 or $80,078 higher than the test year level. This higher figure, the Company contends, reflects the level of services received. Tr. pp. 121, 122. Because it is simply a budgeted number and not based on known and measurable expense, Staff reverses this adjustment by the Company. Tr. p. 533.

The Company on rebuttal contends that Staff has identified no cost or charge that is unreasonable, excessive or imprudent. Staff's adjustment, it states, is simply the amount by which the Company has adjusted the test year level of expense, and is not the product of any logic, reasoning or calculation. Tr. p. 1033.

United Water contends that utility management has both the obligation and right without Commission second guessing or micro management to manage the business and overall expenses within categories if the overall result within the category is not unreasonable. Tr. pp. 549, 550. By way of rebuttal, the Company in Exhibit 25 presents a schedule depicting UWI Management and Service fee expense as a percentage of total operations and maintenance expense. The 1991 through 1996 actual average is 10.73%. Tr. pp. 555, 1033-1035. Staff on cross admitted that it had no testimony or information to indicate that management/service fees at this relationship or level in comparison to O&M generally is unreasonable. Tr. p. 555. The Company also presents other possible scales of reference for use in evaluating the significance of the proposed management/service fees. Tr. pp. 556-558. Suspicion alone, the Company contends, should not trigger a disallowance. Tr. p. 559.

We find:

In examining payments to affiliates we apply the rule announced by our Supreme Court in *Boise Water Corp. v. Idaho Public Utilities Comm.*, 97 Idaho 832, 555 P.2d 163 (1976) and *General Telephone Company v. Idaho Public Utilities Comm.*, 109 Idaho 942, 712 P.2d 643 (1986)

> Although the company may have established actual incurrence of these operating expenses, that fact alone does not establish a prima facie case of reasonableness with respect to payments to affiliates. (Citations omitted). Charges arising out of intercompany relationships should be scrutinized with care.

97 Idaho at 836-837.

In this case we find that the Company proposed adjustment for budgeted increases in fees paid to the M & S Company is a projection not based on actual known and measurable data. It is simply a 5% increase percentage assessment over year end 1996 annual expense. A mere statement that the higher figure reflects the level of services received does not establish the reasonableness of the increased payment to M & S. We therefore find that Staff's proposed adjustment is proper.

Adjust Depreciation Expense IT and Master Plan

The Company in its case used a 10-year life for calculating depreciation expense on its investment in the Information Technology (IT) program and the Master Plan. The IT system, the Company states, replaces a 20-year old main frame that was essentially obsolete. The conversion to a new information system, Staff contends, is not a normal occurrence and it is unreasonable to expect that in ten years the Company will scrap all of its technological equipment and software and start over from scratch. Tr. pp. 531, 533. Likewise, Staff contends, that the Master Plan is an unusual long-term project. Staff proposes that both investments be depreciated over a 20-year period. Staff's adjustment is simply a 50% reduction in the Company's pro forma depreciation adjustment.

On rebuttal, the Company contends that the ten year life proposed for its investment in Information Technology is based on a realistic assumption of service life, given the rapidly evolving nature of computer equipment. *Citing Pennsylvania PUC concurrence*, Tr. pp., 1040-1042. The replaced main frame equipment, the Company reminds the Commission, was a system that was added to, upgraded, retired and modified during the course of its 20 plus years. Tr. p. 1042. Reason would suggest, the Company contends, that a 20-year depreciation period for IT equipment is based on flawed logic.

Regarding its Master Plan, the Company on rebuttal notes that, although its master engineering and operations plan is intended to provide guidance to the Company for many years, the plan contemplates a five-year update cycle to keep it fresh and responsive to the dynamic growth in the Company's service area. Key aspects of operations, the Company contends, can change substantially over a ten-year period. For instance, ten years ago UWI did not anticipate that southeast Boise would be designated a Ground Water Management Area. The conclusions of the Treasure Valley Hydrologic Study may have a potential similar impact in the next ten years. For these reasons, the Company contends that a ten year depreciable life is reasonable. Tr. p. 1044.

We find:

The Company's argument for using a 10-year life for calculating depreciation expense on its investment in its Information Technology program and Master Plan is persuasive. Staff's proposed adjustment is rejected.

Replacing Employee with Contractor

On rebuttal the Company proposes an adjustment to reflect the removal of a proposed new employee (a locator) and attendant labor, benefit and transportation costs as reflected in its direct case and the replacement of this function with contract expense. A locator's job is to "mark-out" mains and service locations for others who are excavating. The Company states that in 1997 it received approximately 68 "mark-out" requests per day. The Company has one employee dedicated to this function who is unable to perform the number requested. Tr. p. 51. Contract expense is estimated to be $58,240 based on the historical level of locator requests, a $13,013 increase over the $45,227 proposed employee costs. Exhibit 21; Tr. pp. 1003, 1004. The Company maintains that "the long-term benefit to the customer is clear." Tr. p. 1004.

By unattested faxed copy of a post-hearing agreement dated June 22, 1998, it is represented that the Company has purportedly contracted with one Melvin L. Cook dba Mel's Locating Company, Nampa, Idaho for locator services. Compensation is at the rate of $8.00 for each underground facility located and marked by contractor. The Company reserves the right to increase or diminish the amount of work to be done with regard to the services to be performed.

We find:

The Company's proposed rebuttal adjustment is an out of test year adjustment for an expense that is not actual but estimated. No money has been spent. We find that it is not sufficiently known and measurable. We find that the post-hearing contract will not be included as a record exhibit. The hearing record is closed. We therefore find it reasonable to deny the Company proposed adjustment for contract expense.

Adjustment for Salary and Benefits Survey Participation

In the discovery phase of this case, Ms. Ullman requested that the Company provide a copy of the Western Management Group 1997 Idaho Cross-Industry Salary and Benefit Survey results, a survey in which UWI participated. The Company responded that it was contractually precluded from disclosing or sharing the results. In Order No. 27449 the Commission indicated that it expected the Company to make an adjustment to reflect removal from its revenue request, the expense incurred due to its participation in the Western Management Group Salary and Benefit Survey. The Company reports that no adjustment is indicated, as the billing was paid in July 1997, outside the test year period. See Exhibit 30; Tr. p. 1054..

We find:

In as much as the Company's payment to the Western Management Group did not fall within the test year period, we find that there is no need for an adjustment, as proposed.

Depreciation Expense Adjustments—Redwood Creek/Island Woods

We find:

Having disallowed a portion of the Company requested rate base for Redwood Creek and Island Woods, the Commission finds that the proportionate related depreciation expense included in the Company's case should be removed. For Redwood Creek, that amount is $15,719; for Island Woods the amount is $1,468.

Depreciation Expense Adjustment—Capitalized Corporate Overhead

We find:

Having disallowed Staff's proposed adjustment related to capitalized corporate overhead, we also disallow the proposed $16,242 elimination of related depreciation.

Operating Results Calculation

Following is the calculation of United Water's operating results based on the revenues and expenses approved in this Order.

OPERATING RESULTS SCHEDULE

Revenues Per Company Exhibit 20, Page 3, Column O	$21,962,493
Eliminate Micron Reuse/Efficiency Adjustment*	173,482
Net Revenues	$22,135,975
Operating Expenses Per Co Ex 20, Page 3, Column O	14,322,231
Correct for:	
Ad Valorem Tax (Co. Post Hearing Exhibit)	5,709
Pumping Power (Co Post Hearing Exhibit)	106,291
Micron Reuse/Efficiency Adjustment*	9,594
PUC Regulatory Fees	(168)
Rate Case Amortization Expense	(61,044)
M&S Co. proforma adjustment	(80,078)
Locator Expense	(58,240)
Adjust Depreciation Expense- Redwood Creek	(15,719)
Adjust Depreciation Expense- Island Woods	(1,468)
Adjust Depreciation for Equity Gross-up of AFUDC (1,617)	
Recalculate Operating Ratio	(739)
Total Adjusted Operating Expenses	$14,224,752
Operating Income Before Income Tax	$7,911,223
Idaho Income Tax	311,466
Federal Income Tax	1,205,827
Net Utility Operating Income	$6,393,930

*See following VI C discussion re: Micron Reuse/Efficiency Adjustment.

IV Rate of Return
Capital Structure

United Water Idaho Inc. is wholly-owned by United Water Works (formerly General Waterworks Corp.), which is wholly-owned by United Water Resources, Inc. Tr. p. 252. The actual capital structure of UWI is 100% equity. Tr. p. 288. Interest expense is allocated to UWI. United Water Idaho Inc.'s common stock is not traded.

One of the issues in this proceeding is the capital structure that should be adopted for the regulated United Water Idaho Inc. Testimony on this issue was presented by Frank J. Hanley (AUS Consultants) for the Company and Terri Carlock for Commission Staff. Post-hearing briefs were also submitted. The following schedule sets forth the related recommendations of each:

COMPONENT	CAPITAL STRUCTURE RATIO (UWI)	RATIO (STAFF)
Long-term debt	54.98%	52.0%
Minority Interest (Preferred Stock)	0.14%	8.0%
Common Equity	44.88%	40.0%
TOTAL	100.00%	100.00%

Reference UWI Exhibit 13, Schedule 8; Staff Exhibit 101, Schedule 17.

United Water employs the actual June 30, 1997 consolidated capital structure of its corporate parent, United Water Works (UWW). Tr. p. 248. The Company represents that this is appropriate because of the following:

1. UWW provides all of the external capital required by United Water;
2. No equity capital has been injected into UWW by its parent United Water Resources (UWR) since the April 1994 merger and thus UWW is not financially dependent on UWR;
3. UWR provides no financial guarantees, pledges, or any of its assets to any lender for the benefit of UWW;
4. No capital of UWR other than UWW could be used to finance United Water's rate base;

5. UWW capital structure ratios are reasonable vis-à-vis a proxy group of five water companies represented as generally similar in risk to United Water;

6. UWW capital structure ratios are consistent with those required by Standard and Poor's (S&P) for a water utility to maintain an A bond rating with an "average" business position, i.e., the business position of UWW. (S&P's total debt to total capital criterion for a water company in an average business position to obtain an "A" bond rating is 52% implying, the Company states, a total equity ratio of 48%. Tr. p. 301.)

Tr. p. 248.

In BOI-W-93-3, the Company's last general rate case, the Commission adopted a hypothetical rate structure for United Water's predecessor, Boise Water Company. Reference Order No. 25640. Commission Staff in this case rejects the Company's UWW capital structure and recommends continued use of the hypothetical capital structure approved in BOI-W-93-3. Tr. p. 479. Staff contends that its proposal is consistent with the Value Line water industry (Tr. pp. 462, 479) and S&P financial benchmark (Tr. p. 485) for a total debt to total capital ratio to maintain the S&P bond rating. Staff states that the stock is traded at the United Water Resource level with United Water Resource controlling the pay out ratio, and thus the retained earnings and common equity ratio for United Water Works. Tr. pp. 492-493; 499-503. This control, Staff contends, has the potential to skew the capital structure ratios lending further support for the use of the hypothetical capital structure for rate making purposes. Tr. pp. 495, 496.

The Company notes that at the time of the Commission's Order in BOI-W-93-3 there was uncertainty regarding the corporate relationships and resulting capital structure as indicated by the following Commission language: "Because the common equity ratio of GWC is expected to be 40% for 1994 and because United's common equity is expected to approximate 40% in the near term, we find that to be a reasonable equity ratio." Tr. pp. 288-290. The Company, citing various legal and regulatory principles, suggests that use of a hypothetical capital structure is appropriate only if the actual capital structure (UWW) is "clearly unsound or extravagantly conservative." Tr. p. 272. In support of the reasonableness of its position, the Company cites a recent Pennsylvania Commission case that found that for a sister subsidiary of UWW, United Water Pennsylvania, Inc., it was reasonable and appropriate to use UWW's capital structure. Tr. pp. 752-753. With only two exceptions (UWI's BOI-W-93-3 and a case involving United Water Delaware now on appeal to the

Supreme Court of Delaware) in recent history, the Company states that the subsidiaries of UWW and the former General Waterworks Corp. have been consistently regulated in their rate cases, both before and after the merger, on a basis of UWW's capital structure. UWI Brief, pp. 3-6.

It is to be noted that UWR's consolidated capital structure consists of 55.20% long-term debt, 8.51% preferred stock and 36.29% common equity. Exhibit 13, Schedule 3. The hypothetical debt ratio of 52% proposed by Staff, is less than the current debt ratio for UWR of 55.2% and the water utility industry average of 56.5%. The 52% debt ratio is also the same as the ratio stated for an "A" rated utility as set forth in Standard & Poor's Financial Benchmarks (Exhibit 13, Schedule 7, p. 3 of 4). Exhibit No. 101, Schedule 15 also reflects these comparisons. UWW's debt is rated "A" by S&P and UWR's credit rating is "A-." Tr. p. 297. The 8% minority interest in the hypothetical capital structure is consistent with the 8.5% preferred stock held by UWR.

United Water Idaho does not directly raise funds in the market. The debt funds are issued at the United Water Works level and the equity funds are retained through earnings or, as contended by Staff, raised at the United Water Resources level. Therefore, the actual capital structure shown on the books of United Water Idaho, Staff contends, has been provided by and supported by one of the parent entities. The UWI capital structure, Staff states, could be double leveraged to reflect this relationship. Rather than double leverage, however, Staff contends that a hypothetical capital structure is more appropriate. Tr. pp. 461, 462. The Company states that Staff's hypothetical capital structure is essentially the same as utilizing double leveraging. This is disputed by Staff, which presents but does not recommend an example of a double leveraged capital structure for UWI. Staff Brief Exhibit A.

The average capital structure ratios for the two proxy groups are depicted in Company Exhibit 13, Schedule 3, page 2. They are for the proxy group of five water companies, 52.19% long-term debt, 1.88% preferred stock, 45.93% common equity capital; and for the proxy group of six Value Line water companies, 55.15% long-term debt, 2.58% preferred stock, and 42.27% common equity capital. Tr. p. 760. The Value Line water industry average capital structure consists of 39.5% in 1997 and is projected to be 40% in 1998. Exhibit 101, Schedule 15.

The Company represents that its primary proxy group of five water companies (Exhibit 12, Schedule 5) is a better and more meaningful proxy than the group of six Value Line water companies. (Exhibit 12, Schedule 6), which was used by the Company as a check and relied upon by Staff. Tr. pp. 280-283. The Value Line check group of six is dismissed by United Water as irrelevant in this case because the companies are much larger and more geographically diverse than United Water Idaho. Tr. pp. 756, 282. Excluding the purported nonrepresentative American Water Works and United Water Resources, Inc. which make up over three-fourths of the total capitalization of the group, Tr. p. 481, the 9/30/97 average capital structure for the remaining companies in the Value Line group would be 53.92% long-term debit, 0.94% preferred stock, and 45.14% common equity. Tr. p. 760.

We find:

The Company's argument for moving away from the hypothetical capital structure that we used in BOI-W-93-3 to the actual capital structure of its corporate parent, United Water Works (UWW) is persuasive. UWW is the entity that issues the debt for United Water Idaho. The UWW capital structure is currently within a reasonable range for utilities of comparable risk.

Cost of Capital

The principal proxy group of five water companies upon which the Company bases its recommended common equity cost rate yields a common equity range including 10.5% (two-stage growth DCF model); 11.6% (Risk Premium Model); 10.5% (Capital Asset Pricing Model) and 12.6% (Comparable Earnings Analysis). Exh. 13,, Sch. 7, p. 4.

United Water in rebuttal Exh. 13, Sch. 8 proposes the following cost of capital and rate of return.

	Capital Structure	Cost Rate	Weighted Cost
Long Term Debt	54.98%	7.80%	4.29%
Minority Interest	0.14%	5.00%	0.01%
Common Equity	44.88%	11.5%	5.16%
Overall Rate of Return	100.00%		9.46%

The Company recommends a common equity cost rate of 11.50%. A point that includes a 20 basis point business risk adjustment, that it contends is appropriate to reflect UWI's extremely small size and the following four major risk factors:

1. Micron reuse program (sales to Micron represent approx 2% of United Waters total annual revenue).

2. Weather—Company realizes about 70% of annual revenue May-October; 12" annual rainfall; 87% of customers residential.

3. Surface water rights are difficult to acquire and increasingly costly.

4. Cost of power may increase with deregulation.

Tr. pp. 265-268, 776, 777.

Staff in Exh. 101, Sch. 17 recommends the following cost of capital and rate of return.

	Capital Structure	Cost rate	Weighted cost
Long Term Debt	52.0%	7.80%	4.06%
Minority Interest	8.0%	5.00%	.40%
Common Equity	40.0%	10.25%-11.25%	4.10%-4.50%
Overall Rate of Return	100.00%		8.56%-8.96%

Differentials due to size and ultimate risk of the utility, Staff contends, should be reflected in the cost of common equity when a point within the reasonable return or equity range is chosen. Staff contends that there is less risk inherent in the capital structure proposed by United

Water, and if adopted, Staff would recommend 10.75% as a reasonable return on equity. Tr. p. 464. Staff also rejects the Company's contention that a business risk adjustment is required. Tr. p. 460.

Staff Exh. 101, Sch. 11 is a comparison schedule of thirteen (13) water company returns on equity for 12 months ending September 30, 1997. The returns range from 8.0% to 14.4%, with an average of 10.8%. Staff calculates the discounted cash flow (DCF) required return on common equity in the range of 8.5% - 10.7%. Exh. 101, Sch 13. Staff also restates Company witness Hanley Exh. 12, Sch. 1, p. 2 on Exh. 101, Sch.14 reflecting calculations shown as not meaningful by Hanley. For the five water company proxy group recommended by United Water, the single-stage growth DCF rate is shown as 9.8% (Exh. 12, Sch. 12) and the two-stage growth DCF rate is 10.5% (Exh. 12, Sch. 16, p.1).

Staff contends that any point within the range of 10.25% - 11.25% is reasonable for a return on equity. Tr. p. 464.

We find:

United Water contends that the use of UWW's capital structure is appropriate in the determination of the cost of capital for United Water Idaho. We approve that capital structure. The Company and Staff are in agreement on the cost rates for long-term debt and minority interest. The cost of debt has been adjusted for the debt refinancing in January and February of 1998. We find the respective rates reasonable and appropriate to use.

The Company also believes a 20 basis point business risk adjustment is required. We do not agree. The Company identifies four unique factors that it contends contribute to its increased riskiness. Regarding the Micron reuse program, the Company may present testimony and a related adjustment in the next phase of this case, if it can demonstrate that Micron's conservation program will result in a significant, known and measurable reduction in consumption. The potential for increased power costs due to deregulation, is highly speculative, especially in Idaho where electric restructuring has not been approved. Power costs are an operating expense for United Water. In this case, we have permitted an adjustment for an out of test year increase in power costs. Regarding the riskiness of surface water rights, we find that the Company in this case presents no evidence that it will have difficulty in securing water rights. Tr. p. 81. Regarding weather, the Company receives an adjustment for weather normalization. The Company will have the opportunity to address rate design in the next phase of its case.

In considering the record, and the business, financial and regulatory risks of United Water, we find that a return on equity of 10.75% using the Company's proposed capital structure is a midrange return that fairly compensates the shareholders for the risks they assume by investing in United Water Idaho. We find that such a return also reflects our consideration of the quality of service and management provided by United Water.

To summarize, United Water's approved capital structure and overall rate of return are as follows:

COST OF CAPITAL

Component	Cost Ratio	Weighted Rate	Cost
Debt	54.98%	7.80%	4.29%
Minority Interest	0.14%	5.00%	0.01%
Common Equity	44.88%	10.75%	4.82%
Required Rate of Return on Rate Base			9.12%

V Revenue Requirement

The Company's additional revenue requirement, which we find to be fair, just and reasonable, is $1,593,095 calculated as follows:

Rate Base	$80,424,286
Rate of Return	9.12%
Net Operating Income Required	$7,334,695
Net Operating Income Realized	$6,393,930
Net Operating Income Deficiency	$940,764.00
Gross-up factor	1.6816
Revenue Increase required	$1,581,989
Percent Increase	7.15%

VI Miscellaneous

A. Timing of rate increase — Motion to Strike

On March 19, 1998, United Water filed a Motion with the Commission seeking to strike identified portions of the prefiled testimonies of Thomas Power and Sharon Ullman. Specifically, the Company sought to strike the portion of each testimony that proposed to defer the rate adjustment and recovery of any determined revenue deficiency until after completion of the cost of service and rate design phase of this case.

United Water contends that this issue has been decided; that in authorizing the bifurcation of the case, the Commission implicitly accepted the Company's proposal to begin recovery of any revenue deficiency found to exist in the revenue requirement phase of its rate case through an immediate uniform percentage increase. United Water contends that the Commission is without authority to extend the suspension period and that to delay any recovery would be to deny the Company an opportunity to earn its authorized rate of return, and would require it to perform its public service obligation without adequate compensation. Citing *Idaho Code* 61-622; *Citizens Util. Co. v. Idaho Public Util. Comm.*, 99 Idaho 164, 579 P.2d 110 (1978).

The intervenors argue that the statutory suspension period preproposes that the Company has filed a complete rate case, i.e., a case including "appropriate cost of service studies." Reference IDAPA 31.01.01.121.01.e. Dr. Power asserts that the bifurcated approach is merely a strategy of the utility to hold down public outcry and thereby enhance the possibility of a larger recovery. The Idaho Citizens Coalition contends that moving to strike testimony with which one disagrees is <u>not</u> an appropriate way to seek to affect the outcome of this case. The Coalition contends that United Water can argue its position regarding the timing of a rate increase (if any) in its rebuttal testimony, through its witnesses at the public hearings, through cross-examination of opposing witnesses, or it can make those arguments in brief. It also has the opportunity, it states, to call for reconsideration if it does not like the Commission's decision about the size and timing of any rate increase that is approved.

The Commission denied the Company's Motion in Order No. 27461, finding that the Commission's Order and Notices required no clarification, and apprising the Company that the Commission as fact finder and decision maker, was inclined to admit all relevant and arguably reliable evidence and that it possesses the expertise to assess the relative probative value of evidence admitted.

At the hearing the Company renewed its Motion to Strike. Tr. pp. 404, 714.

We find:

For reasons expressed in Order No. 27461, we continue to find it reasonable to deny the Company's Motion to Strike. As to the intervenors underlying argument, we find that it was somewhat presumptuous of the Company to assume that it would not be necessary to present a full rate case, including cost of service and rate design. The Commission's Rules indicate what a general rate case filing should include. IDAPA 31.01.01.121. The Commission could have dismissed the Company's filing as incomplete. IDAPA 31.01.01.121.03. Nevertheless, we instead found its proposal to bifurcate to be an administratively efficient and judicious use of resources and a procedure that provided the Commission and parties a better opportunity for focused and thoughtful analysis and consideration of all the issues. Order No. 27293. We further found the proposed procedure to be a sequentially logical one and indicated the Company would be required to file a separate cost of service and rate design application within 30 days following the final Order in this proceeding. While we did not directly address the issue of the timing of any authorized increase in our prior Order, we find it reasonable and fair to allow the increase to go into effect now that a revenue deficiency has been found to exist.

B. UWI Motion to File Late Filed Exhibit No. 33 —

On June 11, 1998, United Water filed a Motion seeking to introduce the Company's Idaho State Tax Commission 1998 Market Value Appraisal. In Exhibit 5, Schedule 3, page 1, the Company estimated that the appraised market value for 1998 would \$70,624,792. The proposed late filed Exhibit 33 provides the Commission with the 1998 actual appraised market value, \$70,956,346.

We find:

The Commission notes that the appraised market value is used in determining the Company's ad valorem tax obligation, which is part of revenue requirement calculations. We find that an actual known and measurable market value is preferable to an estimated number and therefore find it reasonable to grant the Company's Motion and admit the late filed Exhibit 33.

C. UWI Rebuttal Adjustment— Micron Reuse/Efficiency Program

At hearing the Commission granted a Staff Motion to Strike regarding Company rebuttal testimony and related exhibits dealing with an adjustment it proposed for Micron consumption. Tr. pp. 726-731, 790-793. The Commission agreed the information regarding the projected change in Micron consumption was filed too late for the other parties to have an appropriate and meaningful chance to respond. The Commission granted the Company leave, however, to bring the issue back to the Commission as part of the cost of service/rate design phase of its rate case. Tr. p. 793.

We find:

The Commission reaffirms its decision granting Staff's Motion to Strike. The Company's proposed adjustment is accordingly rejected.

D. Ullman Challenges Re: Reasonableness of UWI Wage/Salary/Benefit Expense

Citing specific examples including the salary-benefit package of the Company's president and wages for meter readers, Ms. Ullman contends that the salary, wages and benefits offered by the Company are excessive and not comparable to area averages. No specific adjustments were proposed.

We find:

Based on the information presented and studies reviewed, we are unable to find that the Company's salaries, wages or benefits are unreasonable. We accordingly make no related adjustment in the Company's operating expenses.

VII Service and Water Quality (UWI-W-96-6)

The Commission in Order No. 27229 determined that the identified service and water quality issues raised in the filings and submitted investigative reports in Case No. UWI-W-96-6 (In the Matter of the Investigation of United Water Idaho Inc. and its Ability to Provide Adequate Service and Water Quality) were also at issue in this case. Staff Exhibit 112. The water quality issue identified in the 96-6 case was the presence of iron/manganese in the Company's source waters at levels exceeding the secondary maximum contaminate levels (SMCLs) listed in the federal Safe Drinking Water Act (SDWA). Secondary contaminates are classified as non-health threatening by the Environmental Protection Agency (EPA) and the State Division of Environmental Quality (DEQ). The problem manifests in the water as objectionable color, taste and odor.

Of the Company's 61 ground water wells included in Staff's report, 23 produced water that contained iron and/or manganese that exceeded the voluntary SMCLs. Those wells represented approximately 35% of the Company's total rated supply capacity. The problem is generally most acute during the summer months as demand increases.

The primary focus of the Company in dealing with customer water quality complaints is to reduce the amount of water supplied to the system from problem wells. The Company also sequesters at each problem well to keep the iron and manganese in solution. Additionally, the Company has proceeded with other possible solutions to replace existing problem supplies including investigating the use of aquifer storage and recovery (ASR), identifying aquifers of high quality water, and redrilling and replacing existing wells.

Staff in its report estimated that the Company in its effort to improve the aesthetic characteristics of its water was spending in excess of $460,000 per year which represented about 2.3% of the Company's revenue collected from customers. Exhibit 12, page 16. In the instant case Staff identifies $346,494 as revenue requirement related to improving aesthetic water quality.

The water quality improvement alternatives implemented or proposed by the Company are water system alternatives. Staff notes additionally that there are also in home water treatment alternatives that customers can implement, including mechanical gravity and pressure filters, iron and sulphur traps, ozone treatment, chlorine and charcoal filters, and reverse osmosis filters.

Staff concludes that the cause of water quality complaints within the Company's service area seems to be due primarily to high levels of iron and manganese introduced into the system to varying degrees by existing production wells. However, it states, other factors such as the presence of iron bacteria, the layout of the distribution system, system flushing activities of the Company and the proximity of other wells of high quality seem to greatly influence how, where and when problems occur. In addition, customer perceptions, tolerances and expectations, it states, as well as Company communications and customer service drive the number of actual complaints that are used to determine the extent of the problem. Given the subjective nature of aesthetic customer complaints, Staff contends that it is difficult to determine how serious the problem is, how it is best addressed and how much money should be spent.

Addressing Staff's attempt to quantify the Company's aesthetic water quality costs, United Water contends that 100% of its revenue requirement is a result of supplying or improving water service to its customers, which includes its basic ability to serve, its compliance with EPA and DEQ standards, and its attempts to provide its customers with aesthetically acceptable water. Tr. pp. 874-876. Arguably the standard that the Company should adopt in the aesthetic area, it contends, is compliance with SDWA secondary standards. However, this approach it states may not always give the customers the best value added for the additional cost. Economy and efficiency, it states, must also be considerations. The measurement of success in its efforts, it states, may very well be reducing the number of customer complaints concerning the aesthetic water quality. Tr. p. 876.

In a November 1997 Status Report filed with the Commission regarding specific action plans to address water quality concerns, the Company represented that 1) it anticipated making application to DEQ and Water Resources by February 1998 for ASR pilot approval; the Company now expects to make formal application in July . Tr. p. 967; 2) that it would post on its web site in 1998 a general information notice explaining the underlying quality issues regarding iron and manganese — the Company has put the notice together and has distributed it as a bill stuffer; not on web site yet, Tr. p. 968, and 3) that it was preparing a Consumer Confidence Report on overall water quality that it expected would be available by April 1998; the Report is not yet completed. Tr. p. 968.

We find:

We acknowledge the continuing efforts of United Water to reduce the number of customer complaints related to the presence of secondary contaminates (iron and manganese) in its supply waters and to better educate its customers regarding the nature of the problem and potential solutions, including in home measures customers may take themselves. We encourage the Company to continue with its efforts. We note, as the Company and Staff have suggested, in any cost/benefit analysis of mitigation measures there is a point beyond which additional money should not be spent. We also note that it is reasonable for the Company to use its supply waters from problem wells during short-term periods of emergency, when to not do otherwise would result in a curtailment of supply and an inability to fill its reservoirs.

VIII Intervenor Funding

Timely Petitions for Intervenor Funding were filed by Idaho Citizens Coalition and Sharon Ullman. Reference IDAPA 31.01.01.161. United Water on June 4 filed a response and objection to the Petitions for Intervenor Funding. Each petitioner thereupon filed a reply, Ms. Ullman on June 9 and the Idaho Citizens Coalition on June 19.

Citizens Coalition

The Petition of the Idaho Citizens Coalition requesting $6,955 comports with the requirement of Rule 161 of the Commission's Rules of Procedure. Dr. Power's testimony for the Coalition dealt with three issues: (1) the Boise River diversion, (2) the timing of any approved increase in rates and (3) methods for controlling the ongoing costs associated with the expansion of the water system. The Coalition's positions on each of the issues, it states, differed materially from Staff, which either took no position or different positions on each.

United Water questions the materiality of the Coalition's contribution in this case. The Company, as it did in its repeated Motions to Strike, reiterates its understanding of Order No. 27556, interpreting the Commission's language as a rejection of the Coalition's proposal to defer any change in rates until completion of the rate design and cost of service phase of the Company's rate case. The Company concludes in rather summary fashion that in any event, Dr. Power's proposal runs contrary to clear Idaho law.

The Company challenges Dr. Power's testimony on the Boise River diversion as being largely duplicative of Staff's evaluation, albeit conceding that Dr. Power placed more emphasis on the "extreme emergency" provision of *Idaho Code* § 61-502A. The Company characterizes Dr. Power's testimony as flawed by his "continued insistence that construction of the diversion was a voluntary business decision and his refusal to acknowledge that construction was necessitated by a mandate from government. . . ."

The Company dismisses Dr. Power's discussion of geographically deaveraged rates as a means of addressing growth and the number of customers being served and the location of those customers in places with relatively high costs to serve as a theoretical exercise relating more directly to rate design, and suggests that the Commission consider deferring the Coalition's Intervenor Funding request until the conclusion of that proceeding.

Sharon Ullman

The Petition of Ms. Ullman requesting $4,696.22 comports with the requirements of Rule 161 of the Commission's Rules of Procedure. Ms. Ullman in this case addressed and challenged the reasonableness of Company salaries and benefits, overhead costs, rate case expense, requested rate of return, the timing of any authorized rate increase, the comparative cost of UWI water with other area water providers, the used and useful standard, ad valorem tax expense, attorney fees, and administrative matters. Ms. Ullman states that the positions she advanced on almost all of the issues addressed were different than those addressed by Commission Staff.

United Water disputes Ms. Ullman's contention that she somehow represents the public or is acting on behalf of United Water's customers and recommends that her request be denied. Authority to represent the public cannot be a process of self-anointment, the Company contends, but must be conferred by those whose interests are purportedly represented. Individual citizens are certainly entitled to express opinions on issues pending before public bodies, the Company states, but in the absence of some delegated authority from others, they do so in their own name.

Ms. Ullman by way of response contends that to the extent her interests are indistinguishable from ratepayers generally, the validity of her representative participation is proved. She reminds the Company and Commission that her full participation in Commission proceedings as an affected customer is encouraged by *Idaho Code* § 61-617A. Ms. Ullman reminds Mr. Miller, the Company's attorney, that when he himself was a member of the Commission, the Commission declared "Ms. Ullman's participation in this case was insightful, well prepared and helpful to this Commission. Her effectiveness and knowledge of an arcane subject were impressive. We appreciate her involvement." Ms. Ullman has participated in numerous United Water (Boise Water) cases, and in the most recent case was granted Intervenor Funding.

We find:

Pursuant to *Idaho Code* § 61-117A, the maximum award of intervenor funding that may be made in any one case is $25,000. We find that the participation of both the Idaho Citizens Coalition and Ms. Sharon Ullman materially contributed to our decision in this case. The testimony of the Coalition was detailed and well reasoned. The testimony of Ms. Ullman offered a different perspective. The intervenors advanced positions differing materially from those of Staff on issues of concern to all of United Water's customers. We find that it would constitute a significant financial hardship for the intervenors if they are not awarded funding. We find it reasonable to award the Coalition $6,955, the full amount requested. Ms. Ullman has requested $4,696.22. Included within her itemization of expense is 113 hours @ $40/hour. While Ms. Ullman may feel that the number of hours was reasonable to spend, we find that it exceeds a reasonable level of expense for purpose of intervenor funding. The number of hours we find reasonable are the total consulting/research hours itemized by the Coalition in this case, i.e., 81 hours. Making that adjustment, we authorize an award to Ms. Ullman of $3,416.22, 81 hours @ $40/hour, plus copying ($129.26) and postage ($46.96).

United Water is instructed to pay these amounts within 28 days from the date of this Order. The Company is further directed that these costs, which we find to be an embedded part of authorized rate case expense, should be amortized over three years.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over United Water Idaho Inc., a water utility, and its Application in Case No. UWI-W-97-6 pursuant to the authority and power granted under Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

ORDER

In consideration of the foregoing and as more particularly described above, IT IS HEREBY ORDERED and the Commission hereby authorizes United Water Idaho Inc. to increase its revenues by $1,581,989 or approximately 7.15%. The Company is directed to file amended tariff sheets for rates and charges in compliance with the terms of this Order. The rate increase that we authorize is effective for service rendered on and after July 1, 1998.

IT IS FURTHER ORDERED and United Water Idaho Inc is directed to file with the Commission Secretary a separate cost of service and rate design application within thirty (30) days from the date of this Order.

IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of $6,955 and to Ms. Sharon Ullman in the amount of $4,696.82. United Water Idaho Inc is directed to pay the intervenors within twenty-eight (28) days from the date of this Order.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. UWI-W-97-6 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in this Case No. UWI-W-97-6 . 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 day of June 1998.

Dissenting (See Attached)
DENNIS S. HANSEN, PRESIDENT

RALPH NELSON, COMMISSIONER

MARSHA H. SMITH, COMMISSIONER

ATTEST:

Myrna J. Walters
Commission Secretary

vld/O:UWI-W-97-6.sw6

DISSENT OF COMMISSIONER DENNIS S. HANSEN
Order No. 27617, Case No. UWI-W-97-6

I disagree with parts of the majority opinion and the amount of revenue increase granted to United Water Idaho Inc.

NORTH STATE ACQUISITION

First, I do not believe that the North State acquisition adjustment of $577,664 should be included in rate base. The North State/Garden City exchange was a discretionary decision made by the Company and municipal authorities. Tr. p. 517. The Company's investment in Garden City facilities should not be allowed in rate base on the grounds that the purchased plant was previously contributed, i.e., that the assets were originally contributed to public service by developers and or customers at no cost to Garden City.

As pointed out in the testimony of Staff witness Lobb, the revenues generated by the customers within the North State area, are only sufficient to cover the costs associated with the purchase price of the distribution system, $577,664, and cover operating expenses. With the increase in the customer base (new North State customers minus Millstream customers lost), the revenues generated are sufficient to cover either the investment cost or the source of supply costs. However, I am not convinced that the revenues are sufficient to cover both the costs associated with the acquisition adjustment and the source of supply necessary to provide service to the customers. By allowing this expense, the general body of customers is being asked to subsidize the water supply costs of the North State area. I don't think it is fair that the general body of customers are required to subsidize either United Water Company's investment in Garden City or the water supply costs.

The Company, in Case No. UWI-W-95-2, as noted in our Order No. 26562, made a commitment to hold harmless the Company's other customers from the consequences of the transaction. As noted in the testimony of Staff witness Smith, this transaction accelerates the timing of a new water source and absent a contribution from rates to support source of supply investment imposes a cost subsidy on the Company's other customers. I concur with the language on page 6 of this order expressing the rationale to disallow inclusion of the North State acquisition adjustment. This reasoning provides sufficient evidence to disallow recovery of the acquisition adjustment.

CAPITALIZED CORPORATE OVERHEAD

Another area of concern in this order is the acceptance of capitalized corporate overhead of $787,735. Given the information provided, there is no basis to know whether these overheads reflect a fair allocation of the costs to United Water Idaho by United Water Resources. The Staff contends that an audit trail was difficult to follow in the records provided by United Water Idaho. Complicating the audit in this case and the reliability of test year data was a mid-test year change by the Company in its accounting and time reporting systems and procedures.

An audit should be conducted before the full amount is granted in rate base. To me, what may appear to be a good corporate decision of United Water Resources, Inc. may not necessarily be the most economical decision for the Idaho operation in isolation. What I am saying is that corporate decisions may produce inter-corporate subsidies among the operating units. Staff identified the Company's vehicle lease program and ramifications of a municipal condemnation of a United Water Resource subsidiary in Rio Rancho, New Mexico as activities that raised flags regarding the affiliated web of companies and the related operating consequences affecting United Water Idaho.

BOISE RIVER INTAKE

The Boise River intake is another expenditure that should not be included in the general customer's bill. This $1.9 million expense by the Company is an investment into the future, which the Company says **may** be needed by the year 2005. Recognizing that there is no immediate need for the diversion waters to meet demand now or for several years into the future, I oppose allowing the amortization of the Boise River diversion in expenses paid by customers until it is used and useful. This is a case where the Company has built ahead of its needs. The Company does not even have water rights that would allow it to operate the diversion. This type of future investment without any advance knowledge being given to the Commission, should not be allowed . . . it makes the Commission not obligated in any way.

I do **not** believe the "supposedly" lower cost business opportunity for United Water Idaho constitutes an "extreme emergency." Also, in a letter concerning the project (Exhibit 110), Mr. Carl Ellsworth of the Public Works Department with the City of Boise, states that he was assured by United Water Idaho that they would not include their share of the capital costs of this project in rate base until the project is being fully used.

NORTHWEST PIPELINE

I also disagree with the majority decision allowing United Water Idaho to recover amortization of its investment in the Northwest Pipeline. First, there was no urgency. The deficiency was no greater in 1997 than in past years. Second, with a planned 8MGD Marden treatment plant expansion scheduled to come on line in May 1999, the deficiency is short term. The Company also failed to utilize other supply resources available to it, such as the Swift No. 3 well, Garden City contract supply rights, conservation measures during 1997 peak requirements.

Lengthy distribution pipeline constructed ahead of development places a substantial portion of the cost of new development on the backs of existing ratepayers rather than through developer contributions, as the line extension rules would otherwise require.

Dennis S. Hansen, Commissioner

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO REVISE AND INCREASE RATES CHARGED FOR WATER SERVICE.

CASE NO. UWI-W-97-6

ERRATUM NOTICE

On July 6, 1998, IPUC Order No. 27617 was issued by this Commission. The following change(s) should be made to that Order:

Page 54, Order Section, paragraph 3

READS:

"IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of $6,955 and to Ms. Sharon Ullman in the amount of <u>$4,696.82</u>. United Water Idaho Inc. is directed to pay the intervenors within twenty-eight (28) days from the date of this Order."

SHOULD READ:

"IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of $6,955 and to Ms. Sharon Ullman in the amount of <u>$3,416.22</u>. United Water Idaho Inc. is directed to pay the intervenors within twenty-eight (28) days from the date of this Order."

DATED at Boise, Idaho, this day of July 1998.

Myrna J. Walters - Commission Secretary

bls/O-uwiw976.err

Office of the Secretary
Service Date
September 6, 2000

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO REVISE AND INCREASE RATES AND CHARGES FOR WATER SERVICE.	))))))	**CASE NO. UWI-W-00-1** **ORDER NO. 28505**

SYNOPSIS

This is a final Order determining the revenue requirement and setting rates for United Water Idaho Inc. (United Water; Company). By this Order, the Idaho Public Utilities Commission authorizes United Water to increase its revenues by $2,070,325 or approximately 7.80%.

SUMMARY

United Water serves approximately 65,051 customers within Ada and Canyon Counties, Idaho. The Company's sources of water supply in its interconnected core area (approximately 140 square miles) consist of the Marden Water Treatment Plant with a production capacity of 16 million gallons per day, 77 deep wells and 24 reservoirs with storage capacity of 30.7 million gallons. The combined production capacity of all wells and the treatment plant is approximately 100.3 million gallons per day (MGD). The Company also serves four satellite systems with 8 wells that produce 5.5 MGD.

On February 2, 2000, United Water filed an Application with the Commission for authority to increase its rates and charges for water service. United Water stated that additional revenues were necessary to recover increased operating expenses and costs associated with plant additions, and to produce a fair rate of return. The Company contended that the proposed changes in its rates and charges are just and reasonable and are necessary for the Company to continue to provide adequate and reliable service to its customers.

At hearing, the Company reduced its requested revenue increase from $3,057,100 (11.57%) to $2,901,696 (10.99%). Exh. 34, p. 3. Staff in post-hearing exhibits recommended a $1,834,356 (6.91%) increase. Rev. Exh. 114; Tr. p. 720. Because cost of service and rate design issues were recently examined in the second phase of the Company's last general rate case, United Water Case No. UWI-W-98-3 (Order No. 28043, May 26, 1999), the Commission in a prehearing order determined that a cost of service study was not required in this case. Reference Order No. 28313.

Pursuant to Order No. 28291 issued February 23, 2000, the proposed schedule of rates and charges was suspended for a period of thirty (30) days plus five (5) months from the adjusted proposed effective date of March 3, 2000. Reference *Idaho Code* § 61-622.

Public hearing in this case was held in Boise, Idaho on July 11-12, 2000 and August 1, 2000. The following parties appeared by and through their respective counsel:

United Water Idaho Inc.	Dean J. Miller, Esq.
Commission Staff	Scott D. Woodbury, Esq.

The Coalition of United Water Customers, although previously granted intervenor status, neither participated in nor appeared at the hearing.

At hearing, United Water proposed a rate base of $98,881,234. By this Order, we make the following adjustments to that proposed rate base: (1) elimination of accumulated depreciation on advances, (2) reduction of Redwood Creek investment, and (3) reduction of Raintree investment. We approve a rate base for United Water of $98,862,937. We also make numerous adjustments to the Company's proposed operating results as explained below.

We adopt a return on equity for United Water of 10.6% and an overall rate of return of 8.843%. This yields an increased revenue requirement of $2,070,325, which we authorize be recovered by a uniform percentage increase in rates and charges for all customers. Water usage on and after September 5, 2000 will be billed at the rates approved in this Order.

This Order is based upon our review of the record in this case including the transcript of proceedings, exhibits and the Company's post-hearing brief. The Commission has also reviewed its Orders in Case No. EUW-W-94-1 (Eagle Area Certificate Case), Case No.UWI-W-97-4 (Eagle City Contract) and other Orders specifically referenced herein.

FINDINGS

I. Test Year

United Water proposes a historical test year ending September 30, 1999 with operating adjustments to both rate base and operating results for post test year changes. Staff objects to some of the adjustments but did not object to the proposed test year.

Findings:

The use of a historical test year ending September 30, 1999 with proforma adjustments is reasonable for the purposes of this rate case.

II. Rate Base

United Water in its Application proposed an adjusted rate base of $98,992,133. Reference Exh. 15, p. 1. As set forth in Company rebuttal Exhibit 34, p. 1, the Company proposes a restated rate base of $98,881,234.

The Company has agreed to and incorporated the following Staff proposed adjustments in its rebuttal rate base calculation:

• Update Collector #3 project C00A106	$60,100
• Eliminate Chlorine Equipment Project C00B001	($85,000)
• Eliminate Software Project C00J001	($16,000)
• Reduce Water Rights Project C98A004	($70,000)

Undisputed acquisition projects proposed for rate base treatment are $58,000 for Barber Water.

Also undisputed is the proposed rate basing of the "northwest pipeline" in the amount of $940,000. This project was previously disallowed in Case No. UWI-W-97-6 (Order No. 27617). Also unopposed by Staff is rate basing the remainder of the Company's net investment in Island Woods in the amount of $140,271, the $73,400 previously disallowed in Case No. UWI-W-97-6 plus additional investment of $66,871.

Findings:

In Case No. UWI-W-97-6 the Company failed to persuasively demonstrate to the Commission that its decision to construct the northwest pipeline was for its customers a prudent decision, that it was the best economic and planning alternative available to it or that it was even needed. It was not contested in that case that the pipeline was otherwise "used and useful." Our decision was directed by the Company's failure to avail itself of what we found to be other more economic alternatives. In this case testimony regarding changes in water supply and peak day demand and evidence of transmission/distribution system constraints persuasively demonstrated that the northwest pipeline is not only used and useful but is now needed to meet the West Main service level requirements. The Commission agrees that it is now reasonable to allow a rate base addition for the northwest pipeline in the requested amount of $940,000.

The Commission also recognizes that customer growth in the Island Woods subdivision, a part of the Company's 1994 expansion into the Eagle area, now provides sufficient additional revenue to support the Company's previously excluded and additional investment. We find it reasonable to allow a rate base addition for Island Woods in the amount of $140,271.

The following proposed adjustments remain disputed:

		Amt. incl. in UWI request	Proposed Adjustment
!	Accumulated Depreciation on Advances	—	$134,853
!	Redwood Creek	$472,684	($271,506)
!	Spurwing	$ 52,837	($52,837)
!	Raintree	$828,943	($828,943)

Advances for Construction—Depreciation Expense Adjustment

Commission Staff in its direct testimony proposed a $218,637 reduction in revenue requirement related to depreciation expense on property advanced by developers. Exh. 112. As reflected in post-hearing Exhibit 2 and Staff Revised Exhibit 111 the Company and Staff agree that a more appropriate estimated figure for adjustment to depreciation expense, if accepted, would be $134,853 rather than $218,637. Tr. p. 496. Staff's proposal is a change in depreciation practice for United Water. The appropriateness of the practice has never heretofore been specifically addressed or challenged. Tr. p. 695. Staff contends that because the capital for these projects is not provided by investors and because advanced property is not included in rate base that depreciation charged to customers is inappropriate. Exhibit 112; Tr. p. 683. Allowing depreciation on plant constructed with advances, Staff contends, places the risk of speculative development on current customers. Tr. p. 682. Advanced property does not qualify for rate base treatment until the advance is returned to the developer. Tr. p. 683. There is also a potential for unrefunded advances to roll-over to a contribution at the time the repayment period ends. Tr. p. 695.

United Water opposes the adjustment contending that the practice of charging depreciation on advances has been routinely followed and should not be changed in the context of a single utility's rate case. Tr. p. 493. The Company notes that when a utility receives an advance, it also incurs a liability of repayment. It is the utility's investors, the Company contends, who eventually supply the capital that funds the repayments, and depreciation, it argues, is obviously appropriate with respect to investor-supplied capital. Post-Hearing Brief p. 26. Finally, the Company contends that the recommended change in accounting policy, if accepted, would have adverse consequences, i.e, (1) diminished cash flow, (2) temporary mismatch between rate and book treatment, and (3) would be time consuming and require significant administrative effort. Tr. pp. 494, 495.

The NARUC Uniform System of Accounts for Class A water utilities while specifically addressing depreciation practice with regard to contributed property (Account 403, Depreciation Expense; Account 271, Contributions in Aid of Construction) provides no direct guidance on depreciation practices with regard to advanced property (Account 252, Advances for Construction). Tr. p. 497. Some states, the Company reports, permit depreciation expense on advanced property, others do not. Tr. p. 494. This adjustment would increase the Company's rate base by $134,853 and decrease depreciation expense by the same amount.

Findings:

The Commission finds that the Company's practice of charging customers for depreciation on advances is a practice that should end because advanced property is neither included in rate base nor is it funded with utility investor capital until the advance is refunded. We find it reasonable to address the issue in this case. We find Staff's proposed $134,853 adjustment to be reasonable.

Redwood Creek

Redwood Creek was acquired by United Water in 1994 when the Company expanded its service territory into the Eagle area. Tr. p. 236. The Company's growth projections for the Eagle area were challenged by Staff in that case as being unrealistic. In support of its proposed acquisition, the Company assured the Commission that other customers would never be required to subsidize its Eagle area investment. Reference Case No. EUW-W-94-1, Order No. 26337.

In this case United Water seeks to rate base the balance of its remaining undepreciated capital investment in Redwood Creek, $472,684. Staff points out that test year revenue generated from Redwood Creek customers does not fully support the overall investment.

Staff contends that the Redwood Creek facilities are not needed to serve the needs of customers in the Company's integrated system. Staff recommends that Redwood Creek facilities continue to be viewed on a stand alone basis and that Redwood Creek rate base be limited to $302,400, the amount of supported investment. Tr. p. 628. Staff recommends that $271,506 of the Redwood Creek facilities costs be excluded from rate base as unsupported investment and that $7,371 of depreciation expense associated with the unsupported investment be eliminated. Tr. pp. 629, 630. Included in the unsupported Redwood Creek investment is a recent replacement pump designed specifically, the Company states, to deliver water to the Floating Feather booster pump that supplies the northwest pipeline. (Work Order No. C98 A105—$56,127). Tr. p. 175.

The Company objects to Staff's proposed adjustment and contends that it is inappropriate to assess Redwood Creek on a stand alone basis. Post-Hearing Brief p. 13. The Company maintains that the pump investment was required to serve the needs of its integrated system and that it would be confiscatory to deny recovery of this investment. Tr. pp. 179, 180. Redwood Creek, the Company contends, is no longer a satellite system. Its facilities and well have been connected by the northwest pipeline to the Company's integrated system. The Redwood Creek facilities, the Company states provide back up to the Company's greater integrated system, necessary redundancy, system pressure stabilization, and fire protection. Because Redwood Creek facilities benefit the integrated system, the Company contends that all investment in the Redwood Creek facilities is now used and useful. Tr. pp. 156, 174, 180.

Should the Commission continue to find it reasonable, however, to view Redwood Creek on a stand alone basis, the Company maintains that it is appropriate to apply surplus revenues from Island Woods to the Redwood Creek deficiency. Island Woods, an Eagle area water system that was acquired at the same time as Redwood Creek, is with this case fully rate based and generates revenue greater than required to support the Island Woods investment. Tr. p. 179. The maximum investment that should be excluded from rate base, the Company contends should be no more than $53,800 to $77,900. See Exhibits 20, 21, 22; Tr. pp. 176-181. Staff disagrees with the Company contending that the Company's other customers are entitled to realize the benefit and additional revenue from Island Woods and should not be required to subsidize Redwood Creek investment by giving up same. Tr. p. 630.

Findings:

The Company in this case seeks to rate base its investment in Redwood Creek. While we find Staff's proposal to treat Redwood Creek on a stand alone basis to be unreasonable, we will require the Company to keep its commitment in Case No. EUW-W-94-1 when it acquired Redwood Creek to hold its other customers harmless. It is also appropriate to recognize that both Redwood Creek and Island Woods acquisitions were approved in the Company's Eagle area certificate case. We therefore find it reasonable to consider revenues from Island Woods in determining the amount of supportable investment for Redwood Creek rate base. Based on approved combined revenues in this case for Redwood Creek and Island Woods, the Commission calculates that the resulting revenues support $392,978 of the Company requested $472,684 rate base investment. The amount we approve is in addition to the $56,127 for the replacement pump, a post-acquisition expense that benefits the Company's greater integrated system.

Having disallowed a portion of the Company requested rate base for Redwood Creek, the Commission finds that the proportionate related adjustments are a reduction in the Company's plant in service of $91,573 and a reduction of $12,047 in accumulated depreciation. The resulting net unsupported amount is $79,706 .

Spurwing

The Spurwing development was served by the Company under special agreement. Reference Case No. UWI-W-98-5. Staff proposes that $52,837 of capital investment associated with Spurwing development be excluded from rate base. Tr. pp. 619, 630. Staff also proposes eliminating associated depreciation expense in the amount of $2,723. Tr. pp. 630, 631. The Spurwing investments at issue (i.e, telemetry/chemical feed equipment (C98 C109); pump (C99 A106)), Staff contends, should be regarded as part of the underlying water system acquisition and as such should be nonrefundable developer contributed distribution plant or water supply plant advanced by the developer, and subject to refund. Tr. p. 630.

The Company opposes Staff's adjustment. Spurwing, the Company maintains, is no longer a non-contiguous system but is now part of the Company's integrated system. It was connected, the Company states, to take advantage of the Spurwing well's production capacity to supplement the Company's west bench service level supply. Tr. p. 435. It is in connection with the integration and not the acquisition, that the Company on rebuttal states that it undertook the two capital projects that Staff challenges. The projects, the Company contends, were for the benefit of the system generally and not for the benefit of the Spurwing subdivision. Tr. pp. 434-35. Spurwing, it states, could have operated without this equipment. As such, the projects were not property that should have been either advanced or contributed by the developer. Post-Hearing Brief p. 11.

Findings:

The Commission finds the Company's reasoning regarding Spurwing to be persuasive. We find the capital investment to be part of integration expense and not acquisition expense. We find that neither advances nor contributions from developers were required. We do not adopt Staff's proposed adjustment.

Raintree

On November 3, 1999, United Water purchased a domestic water distribution system from Raintree Mutual Water Company, Inc. (Raintree). Agreement for Purchase & Sale – Post-Hearing Exhibit 4. Raintree was a nonprofit company organized by developers to provide water service to property under development. Tr. p. 158. The Raintree water system serves multiple residential subdivisions and has no independent source of domestic water supply. Prior to the purchase, the Raintree system was operated by United Water Idaho Operations, Inc. (previously EM^2), an unregulated affiliate of United Water, pursuant to an Operations Agreement signed in September 1995. Tr. p. 158. Water service and operations service began in early 1996. Tr. p. 158. United Water in this case seeks to rate base a net investment in Raintree of $828,942. Tr. p. 160. At the time of purchase there were 830 Raintree customers. Tr. p. 164.

Staff opposes the Company's attempt to rate base Raintree and questions the prudence of the Company's purchase decision. Tr. pp. 611, 676-77. The Company's decision to purchase Raintree, Staff maintains and the Company admits, was discretionary. Tr. p. 746. Staff points out that before the purchase annualized revenue to United Water from water sales to Raintree was $95,483 during the test year. Staff contends that the incremental revenue of $58,783 that the Company will realize from the purchase does not support the investment requested; it will only support an incremental investment of $246,000. Exhibit 122. Additionally, Staff notes that before the purchase the Company's costs were simply those of supplying water. With its purchase the Company has incurred significant expense obligations that it did not have prior to the purchase, i.e., billing and collection costs, meter reading costs (except four 6" meters), distribution costs, O&M on distribution facilities, and depreciation expense. Tr. p. 747. The Company's existing customers after the purchase, Staff contends, are worse off. The Company before the purchase was already generating two-thirds of the total revenue that would be generated after the purchase, yet the Company now has investment and additional expense requirements. Tr. p. 616.

Staff also objects to the manner in which wholesale service was provided to Raintree, contending that Raintree developers received preferential treatment and that the Company deviated from filed rates, line extension rules and regulations. Tr. pp. 619, 632, 634. This is the only instance, Staff is aware of when United Water has allowed a new residential single family development to interconnect to its system and resell general water services. Tr. p. 634. Staff contends that the availability of wholesale service that allows the bypassing of existing tariff rates and rules must be subject to Commission review and approval. Tr. pp. 634, 635.

The Company refutes Staff's reasoning. Up to the time of purchase, United Water customers were receiving a substantial benefit for which they had no investment—this situation, it hypothesizes, could not be expected to continue indefinitely. Tr. p. 732. To justify its rate base request, United Water evaluates the Raintree transaction as if it had entered into a main extension agreement with developers for a fully developed single project in 1995, with full build-out within five years. Tr. pp. 161, 728; Revised Exhibit 7. The 1995 extension rules, it maintains, were used as a benchmark in negotiating an arms length purchase. Tr. p. 191. Extension rules for United Water changed in May 1997 after which time contribution of distribution system facilities was required of developers. Tr. pp. 197, 726. The investment that the Company would have made under the 1995 rules and regulations (guaranteed revenue requirement method), the Company states, is greater than the amount eventually paid. Tr. pp. 130, 195, 265, 744.

The Company disputes Staff's contention that its relationship with EM^2 provided EM^2 and Raintree with any preference or advantage. Tr. p. 256. Line extension rules in 1995 did not apply, the Company contends, because no extensions were made. The Company simply set meters on existing facilities. Tr. p. 261. From the outset of the organization of Raintree, the Company maintains that it always intended to purchase the system. It is a cumbersome operating practice, it states, to have a separate company enclosed within its system. Tr. p. 265.

United Water states that it regarded Raintree developers as sophisticated and financially capable and a credible threat to create a separate water company within its service area. Tr. pp. 182-184, 191, 256. Water was sold to Raintree, the Company maintains, at metered tariff rates. The sale to Raintree it states, was no different than the sale of water to any other customer. Tr. pp. 184, 185. Staff seems to suggest, the Company states, that in circumstances when a customer of United Water intends to resell water purchased from United Water there should either be a tariff or a Commission approved contract for wholesale service. This, the Company states, is the same argument that Staff made in the Eagle case but it did not prevail. Tr. p. 189. There is wisdom, the Company contends, in a policy that simply says as long as the sale is at full tariff rates the Commission can be indifferent to the end use. Tr. pp. 190, 249, 250.

Findings:

The Staff did an admirable job of presenting a case for the imprudence of United Water's purchase of Raintree. We cannot, however, find the purchase to be imprudent. While United Water's customers enjoyed the benefit of revenue from the water supply agreement prior to the purchase, that fact does not make the Company's decision to purchase Raintree unreasonable. The prudency of a utility's investment or expense is determined by examining the reasonableness of the utility's actions at the time the expense or investment was made. *See Rosebud Enterprises v. Idaho PUC*, 128 Idaho 633, 917 P.2d 790 (1995); *Industrial Customers of Idaho Power v. Idaho PUC*, Slip Op. (April 17, 2000).

We will determine the amount of investment to be rate based using the annual Revenue/Investment Model presented by both Staff and the Company incorporating both increased revenue and the Company's overall return as approved by this Order. With the adjustment that we approve, we find that the Company's existing customers are no worse off with the 1999 purchase than they would have been had the Company connected Raintree developments in accordance with its line extension rules. We also find that the customers of Raintree will benefit from the services the Company can provide.

We are not persuaded by the Company's argument that there was no reason to seek Commission approval of the 1995 agreement to wholesale water for resale. *See* UWI-W-97-4 Eagle City Contract (Supplemental Water & Fire Service; Backup Water for Emergency Situations), Order No. 27121, 9/08/97 (Exhibit 23). Tr. pp. 185, 635, 636. The Company shall file all future agreements for approval by the Commission.

We find it reasonable to consider the revenues that will be generated from our decision in this case in determining the amount of supportable investment for Raintree rate base.

The Commission calculates that resulting revenues support $755,500 of the Company requested $828,942. The resulting unsupported amount that will not be allowed in rate base is $73,443.

Rate Base Calculations

Following are the calculations for United Water's approved rate base:

Plant in service	
Per Company Exh. 34, p. 1	$174,900,704
Less portion of Redwood Creek	(91,753)
Adjusted total plant in service	$174,808,951
Less accumulated depreciation	
Per Company Exh. 34	(40,598,443)
Advances	134,853
Redwood Creek	12,047
Net utility plant	$134,357,408
Less (per Company Exh. 34, p. 1)	
Customer advances for construction	(5,850,608)
Contributions in aid of construction	(26,908,211)
Utility plant acquisition adjustment	628,595
Raintree acquisition adjustment	(73,443)
Accumulated deferred income tax	(6,456,432)
Pre 1971 investment tax credits	(19,808)
Add (per Company Exh. 20, p. 1)	
Deferred charges	946,112
Working capital	2,239,324
Total Rate Base	$ 98,862,937

III. Operating Results

As reflected in its initial Application the increase in annual revenue requested by the Company was $3,057,100 or 11.57%. As set forth in Company rebuttal Exhibit 34, p. 3 a revised annual revenue increase of $2,901,696 or 10.99% is requested.

The Company has agreed to and incorporated into its rebuttal Exhibit 34, p. 2, Results of Operations, the following Staff proposed adjustments to operating expense:

- Depreciation on Software Project C00J001 ($3,200)
- Depreciation on Chlorine Equipment Project C00B001 ($4,250)
- Update PUC Assessment rate $ 5,282

The Staff has further agreed to the following proposed adjustments reflecting the use of corrected and updated expense information:

- Adjust updated purchase Power Costs $102,106
- Adjust updated Employee Health Costs ($33,821)
- Depreciation on Updated Collector #3 Project C00A006 $ 1,200

Boise River Intake—AFUDC

In the Company's last general rate case, Case No. UWI-W-97-6, United Water requested rate base treatment of $1,882,531 in capital expenditures for construction of river intake and installation of a transmission main. Tr. p. 165. The Commission disallowed the Company's request stating:

> Except upon on a finding of an extreme emergency, the Commission is prohibited under *Idaho Code* § 61-502(A) from setting rates for any utility that grants a return on construction work in progress or property held for future use which is not currently used and useful in providing utility service.

Order No. 27617; Tr. p. 234.

As reflected in the prior hearing, the river intake facilities consist of "a pipe that goes nowhere and is not hooked to anything." The Company anticipates that the facilities will be utilized to divert surface water for a future water treatment plant in southeast Boise. Tr. p. 171. There is no projected need for the facilities until the year 2005. Tr. p. 235. The Commission in Case No. UWI-W-97-6 authorized recovery of amortization at the level of depreciation of the construction costs in the amount of $37,651 per year. Order No. 27617; Tr. p. 166.

In this case, the Company requests "post-closing AFUDC" for a present net investment of $2,555,658 in the river intake and pipeline and the deferral of the current amortization until the project goes into service. AFUDC, the Company states, is a recognition of the economic costs of unproductive capital, typically for construction expenditures not yet in service. Post-Hearing Brief p. 15. The AFUDC rate requested by the Company is the same rate as its requested cost of capital, i.e., 9.15%. Tr. p. 173. (Requested accounting treatment Tr. pp. 172, 173; Post-Hearing Brief p. 16.)

The Company admits that the underlying facts with respect to Boise River intake have not changed; nor have the statutory requirements of *Idaho Code* § 61-502A. Tr. p. 234. The Company maintains that application of the "used and useful" standard is unfair in instances where the capital investment reduces future costs and/or maintains the Company's ability to provide service in the future. (*Citing* Marden Treatment Plant as an example of how plant constructed in advance benefits customers.) Tr. pp. 166, 167.

Although previously authorized, it is noted that the Company in this case includes no amortization expense for river intake and pipeline in its revenue request, believing post-closing AFUDC is more equitable. Tr. pp. 170, 171. The Company maintains that the Commission authorized treatment deprives the Company of the opportunity to earn a return on its full investment by reducing the amount of investment that will be included in rate base. Allowing a level of depreciation expense does not relieve, the Company contends, but rather compounds the unfairness. The Company's proposal for AFUDC treatment of its Boise River intake expenditure is the same position as supported by Staff in Case No. UWI-W-97-6. Tr. p. 647.

Findings:

The Commission decided this issue in Case No. UWI-W-97-6, Order No. 27617. Neither the underlying facts nor the controlling statute have changed. The Company's demand forecast continues to demonstrate no need for the facilities until the year 2005. The Company's investment in the East Boise River Diversion is still not "used and useful."

Recognizing the potential future benefit to customers we allowed amortization of the Company investment and calculated a depreciation expense allowance of $37,651. The Company in this case reports that its investment has increased from $1,882,531 to $2,555,658. Recognizing its increased investment we find it reasonable to increase its depreciation expense allowance from $37,651 to $51,113.

Investor Relations Expense

Staff's proposed adjustment removes from United Water operating expense, the "investor relations" amount of $82,575 recorded as United Water's allocated share of its (heretofore) publicly traded parent company's (United Water Resources) expense of providing information to corporate shareholders, a Securities and Exchange Commission regulation and reporting requirement. Exhibit 111, p. 1; Tr. pp. 684, 685; Post-Hearing Brief p.27.

United Water Resources is now a wholly owned subsidiary of Suez Lyonnaise des Eaux. The merger agreement that was announced on August 23, 1999 was consummated on July 27, 2000, after receiving required regulatory approvals. Reference UWI letter filed with the Commission Secretary on August 2, 2000.

Suez Lyonnaise is now the sole shareholder of United Water Resources. Staff contends that with only one shareholder and because United Water Resources stock after the merger will no longer be publicly traded, United Water Resources will no longer incur the costs of providing shareholder information. Tr. p. 685.

The Company opposes this adjustment. Even though United Water Resources' stock, it states, will no longer continue to be listed on the New York Stock Exchange and the Company will not be obligated to comply with associated SEC regulations, UWR is not being acquired by a private entity. The new parent is and will continue to be publicly traded and will presumably incur investor relations expense and the Company states it will likely allocate a share of that expense to its subsidiaries. Tr. p. 491; Post-Hearing Brief pp. 27, 28. The Company contends that Staff's proposed adjustment is speculative—a change in test year expense has not occurred and is therefore not "known and measurable." Post-Hearing Brief p. 28. The Company recommends that the expense amount remain unchanged.

Findings:

The Commission finds it reasonable to recognize the consummation of the merger of the Company's parent, United Water Resources, with Suez Lyonnaise des Eaux. We also find it reasonable to recognize that the Company will no longer incur the identified test year operating expense for "investor relations." While we do not rule out that Suez Lyonnaise des Eaux might choose to allocate a portion of its shareholder expense to its subsidiaries, we find that such related expense is not known and measurable at this time. We will look at actual allocations in the future. We find it reasonable to accept Staff's proposed adjustment and to remove $82,575 of "investor relations" operation expense.

M&S Audit

Staff recommends that the Commission consider retaining a management and economics consulting firm to assist the Commission Staff in a study of the economic efficiencies or inefficiencies of the services provided to United Water Idaho by the Company's affiliate, United Water Resources Management and Service Company (M&S). The main question to be answered by such a study, Staff contends, is not whether a charge is appropriate, but rather "can the tasks be accomplished locally (in Idaho) at a lower cost"—also is allocation of cost to Idaho fair and equitable? Tr. p. 673. The cost of such an audit is estimated by Staff to be approximately $200,000 to $250,000. Tr. p. 693.

The Company cites numerous management audits performed at various times over the last 22 years, all consistently coming to the same conclusion, i.e., "allocation methods are quite sophisticated, well documented, and services are provided at reasonable cost." Tr. p. 27. The Company contends that no credible evidence has been presented in this case that an additional study is warranted. Tr. p. 29. Staff itself, the Company notes, proposes no adjustments to M&S charges or allocation procedures. Tr. p. 671. Obtaining the lowest price for functional area services may not be the critical decision factor, the Company contends. Rather, the total overall benefit must be considered (issues of quality, timeliness, experience, and professionalism). Tr. pp. 33, 54. The Company identifies the following as an example of benefits of being part of a larger corporation: (1) treasury functions (lower cost of debt); (2) lower insurance premiums; and (3) economies of scale—purchase contracts, etc. Tr. p. 32. Outside services, the Company speculates, would require careful oversight and related administrative expense. Tr. p. 33. The Company states that it has performed no cost analysis of performing M&S type services in-house. Tr. pp. 51, 54. Nor has the Company analyzed whether contracting with affiliates is the most cost effective method. Tr. pp. 67, 68.

Commissioner Hansen in cross-examination of Company witness Wyatt notes that the costs in 1998 of M&S for services was $1,306,824. For the 12-month period ending September 1999 the cost had increased to $1,409,948, an 8% increase (citing employee relations up 29%; customer and public relations up 59%; accounting/planning/taxes/audit up 24%). Tr. p. 70.

Findings:

On the facts presented in this case, we find no reasonable basis for initiating an investigation and audit of services provided to United Water by its M&S affiliate. The Commission will continue to look closely at the Company's dealings with its affiliate. We expect the Company to look out for its customers and seek to obtain for them the best value for the dollar and to provide service by employing the most cost efficient methods. As our Supreme

Court observed in *Boise Water Corp. v. Idaho Public Utilities Comm.*, 97 Idaho 832, 555 P.2d 163 (1976) and *General Telephone Company v. Idaho Public Utilities Comm.*, 109 Idaho 942, 712 P.2d 643 (1986):

> Although the Company may have established actual incurrence of these operating expenses, that fact alone does not establish a prima facie case of reasonableness with respect to payments to affiliates. (Citations omitted). . . . [T]he utility [has] the burden of proving reasonableness of its operating expenses paid to an affiliate. . . .

97 Idaho at 836-37.

South County—Revenue Adjustment

Staff proposes to increase test year revenues by $136,118 to reflect projected South County revenues in the third year (70% of UWI rates) of the acquisition rate phase-in. Tr. p. 641. The Company has adjusted test year revenue for South County customers in this case to reflect the second year of the phase-in (60% of UWI rates—effective January 1, 2000). Tr. p. 35. Staff contends that the proposed third year rates (effective January 1, 2001) better reflect the known and measurable changes that will take effect during the first year of the general rate adjustment. Tr. p. 620.

The Company opposes the adjustment. Tr. pp. 35-40. Staff , it states, is proposing an out of test year adjustment, contrary to a long standing Commission preference for historical test periods. *Citing In Re Utah Power*, Case No. 1009-84, Order No. 13448 in which use of a future test year was rejected. Post-Hearing Brief p. 21. If 2001 rates go into effect now, the Company states it will for the balance of this year experience a related revenue deficiency.

The Company notes that the Commission in South County/UWI Order No. 27798 stated: The rate phase-in is designed to permit customers to "assess their water usage, to possibly adjust their water consumption habits and to connect (if available) to other irrigation sources." Tr. p. 37. The average annual water consumption of South County customers is 324 ccf, while for United Water the average is 220 ccf. Tr. p. 61. Although the third phase rates may be known and measurable, the Company argues that the associated revenue is not. Higher rates may induce customers to reduce consumption. Imputing future South County revenues, the Company contends, is a mismatch of revenue and expense. Tr. pp. 35, 37, 62, 63.

Findings:

The Commission does have a long standing preference for historical test years. We also recognize that revenues and expenses must be appropriately matched. However, we have made numerous known and measurable adjustments in this case that go well beyond the end of the test year for taxes, labor, employee benefits, power and other expenses. We have also used rates that will be in effect after this Order is issued to determine the rate base allowances for the Company's investment in Redwood Creek and Raintree. It is therefore, reasonable to include the South County revenues at the third year rate for determining revenue requirement in this case.

Ad Valorem Taxes

The Company in its original application made an adjustment to reduce test year ad valorem taxes in the amount of $30,875. This adjustment was made by estimating the appraised value in the year 2000 by applying an average four (4) year growth factor in the appraised value of 2.25% to the 1999 appraisal of $67,964,422. The resulting estimated appraisal of $69,493,621 was multiplied by the most recent levy rate (1999 taxes) of 1.7355% producing an estimated tax of $1,206,079 that is $30,875 less than the test year actual tax of $1,236,954. Staff did not object to this adjustment. We note that even though the appraised value has been increased, the resulting tax has decreased. This can only be due to a reduction in the tax mill levies assessed by the many taxing districts.

At hearing, the Company offered Exhibit No. 32 as an update to its ad valorem tax estimate based upon an agreement with the Idaho State Tax Commission (Exhibit No. 33) regarding the year 2000 appraised valuation. That Exhibit produces an estimated ad valorem tax expense of $1,240,940 which is $4,986 greater than the test year actual expense. Substituting this expense estimate for the estimate included in the Company's original application increases the test year expense by $35,861 from the base case filed with the application.

Findings:

We accept this Company proposed ad valorem tax adjustment using the August 2000 valuation as the most recent known and measurable calculation available at this time.

Operating Results Calculation

Following is the calculation of United Water's operating results based on the revenues and expenses approved in this Order.

Revenue per Company Exh. 11, Col. 4, l. 4	$26,412,890

South County Revenue	$ 136,118
Total Revenues	$26,549,008
Operating Expense per Company Exh. 11, Col. 4, l. 14	$17,128,657
Correct for:	
Depreciation expense on Cancelled Project C00J001	$ (3,200)
Depreciation expense on Project C00B001 not yet defined or started	$ (4,250)
Depreciation expense on Project C00A106 updated cost estimate	$ 1,200
Depreciation expense on Customer Advances	$ (134,853)
Eliminate Investor Relations Expenses	$ (82,575)
Adjust PUC regulatory fee	$ 5,282
Depreciation expense on disallowed Redwood Creek investment	$ (2,037)
Amortization of Boise River Intake Plant held for future use	$ 51,113
Ad Valorem Taxes	$ 35,861
Depreciation expense on disallowed Raintree investment	$ (4,199)
Adjust for Updated Employee Health Insurance	$ (33,821)
Adjust for Updated Purchase Power Costs	$ 102,106
Total Adjusted Operating Expenses	$17,059,284
Operating Income before Taxes	$ 9,489,724
Idaho Income Tax	$ 279,872
Federal Income Tax	$ 1,697,369
Net Utility Operating Income	$ 7,512,483

IV. Rate of Return

Capital Structure – Cost of Capital

United Water Idaho Inc is wholly-owned by United Waterworks Company (formerly General Waterworks Corp.) which is wholly-owned by United Water Resources, Inc. Tr. pp. 320, 321. Interest expense is allocated to UWI. United Water's common stock is not traded. United Water Resources, Inc. is now wholly-owned by Suez Lyonnaise des Eaux.

United Water and Commission Staff agree to the appropriateness of using the following capital structure and cost rates for long term debt and minority interest for regulatory purposes.

Capital Structure	
Debt	56.81%

Minority interest or preferred equity	.12%
Common equity	43.07%
Exh. 18, Sch. 6, p. 1; Exh. 108, Sch. 14	
Cost of Debt	7.52%
Exh. 18, Sch. 6, p. 2; Exh. 108, Sch. 14	
Cost of minority interest	5.00%
Exh. 18, Sch. 6, p. 2; Exh. 108, Sch. 14; Tr. p. 594	

Findings:

The Commission finds the capital structure proposed by the Company and Staff to be reasonable for ratemaking purposes. It is the actual capital structure of United Water's corporate parent, United Water Works (UWW). UWW is the entity that issues the debt for United Water. The proposed capital structure is within a reasonable range for utilities of comparable risk. The Commission also finds the 7.52% cost of debt and 5% cost of minority interest are reasonable.

Cost of Equity

Staff in this case recommends a point estimate for cost of common equity of 10.6%. Staff utilized a comparable earnings method (10.0%-11.0%) and discounted cash flow method (8.6%-9.6%) analysis in determining a recommended range of 10.0%-11.0% with a point estimate of 10.6%. Tr. p. 594.

The 10.6% return on equity point estimate utilized by Staff is based on the following factors:

1. A review of the market data and comparable earnings shown on the schedules in Exh. 108;

2. Use of the water utility group dividend yield in the United Water Resource DCF calculation in Exh. 108, Sch. 13;

3. Average risk characteristics for UWI;

4. Favorable customer relations; and

5. Reasonable capital structure.

Staff recommends an overall weighted cost of capital in the range of 8.585%-9.0616%. Exh. 108, Sch. 14.

Staff on additional direct and cross contends that the 10.6% recommended return on equity meets debt coverage requirements and will not result in a bond downgrade. Staff also stated that an equity adder as suggested in rebuttal is not required above the 10.6% which is 10 basis points above the 10.5% midpoint of the Staff recommended range of 10-11%.

The Company recommends a common equity cost rate of 11.30%. The Company's recommendation is based on the common equity cost rates of discounted cash flow method (DCF), risk premium model, capital asset pricing model (CAPM) and comparable earnings analysis applied to proxy groups of four (avg. cost rate 10.9%) and six (avg. cost rate 11.4%) Value Line water companies.

United Water contends that the Company is more risky than the average company in each proxy group. The Company's unique business risks and small size, it argues, increase its common equity risk by a minimum of 17 basis points, or 0.17%. The recommended range of common equity cost rate, based on the two proxy groups relative to UWI is 11.07%--11.57%. The Company recommends the use of a range midpoint estimate of 11.32% rounded down to 11.30%. The resultant overall cost of capital is 9.15%. Exh. 18, Sch. 1, p. 1.

The Company contends on rebuttal that Staff's technical analysis on cost of equity is flawed and creates a bias toward the low end of reasonable costs. In particular it argues that the Staff range of DCF common equity cost rates is grossly substandard and would not maintain the financial integrity of presently invested capital. Tr. pp. 399-400.

A DCF calculation is a dividend yield plus a growth rate to produce a discount rate or required return on equity. Staff selects a value of 5% for use as the dividend yield. This dividend yield, the Company maintains, is higher than the actual dividend yields of United Water Resource or the proxy groups of water companies (Exh. 18, Sch. 11, p. 1). Post-Hearing Brief p. 17.

It also maintains that the Staff's comparable earnings method approach grossly understates the appropriate indicated common equity cost rate. Finally, United Water argues that Staff underestimates UWI's relative business risk. The Company contends that lack of any sort of tracker mechanism makes the Company more risky and contends that a company that must recover a portion of its fixed charge through its variable rates faces greater risk. Tr. pp. 601-603.

Findings:

United Water argues that Staff's DCF range is substandard and will not maintain the financial integrity of United Water and will result in a downgrading from the A rating. We do not accept this argument. The rate of return authorized by this Commission is only one factor considered by prudent investors and rating agencies when evaluating a utility's stock. We accept Staff's uncontested testimony that the 10.6% point recommendation rather than the DCF range produces an interest coverage ratio of 2.8 times and is within the range for A rated bonds. Therefore, the authorized return alone will not result in a bond downgrading due to low interest coverage.

We do not accept United Water's argument that Staff underestimated United Water's relative business risk. The Commission finds that United Water, despite not having a tracker cost adjustment mechanism, is not as risky as an electric utility. In recent general rate proceedings for Avista Corporation we allowed Avista a cost of equity of 10.75%. We accept Staff's return on equity point estimate of 10.6% for United Water. We find that this return will allow United Water a reasonable return on investment committed to serve the public. The overall rate of return we approve is 8.843%.

Cost of Capital

To summarize, United Water's approved capital structure and overall rate of return are as follows:

COST OF CAPITAL

Component	Ratio	Composite Cost	Rate of Return
Debt	56.81%	7.52%	4.272%
Minority Interest	0.12%	5.00%	0.006%
Common Equity	43.07%	10.60%	4.565%
Allowed Rate of Return on Rate Base			8.843%

V. Revenue Requirement

The Company's additional revenue requirement, which we find to be fair, just and reasonable, is $2,070,325 calculated as follows:

Rate Base		$98,862,937
Rate of Return		
	8.843%	
Net Operating Income Required		$ 8,742,831
Net Operating Income Realized		$ 7,512,483
Net Operating Income Deficiency		$ 1,230,348
Gross-up factor		1.683%
Revenue Increase required		$ 2,070,325
Percent Increase		7.80%

For use in calculating the revenue requirement, a point estimate consisting of a return on equity of 10.6% and a resulting overall return of 8.843% was utilized.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over United Water Idaho Inc., a water utility, and its Application in Case No. UWI-W-00-1 pursuant to the authority and power granted under Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

ORDER

In consideration of the foregoing and as more particularly described above, IT IS HEREBY ORDERED and the Commission hereby authorizes United Water Idaho Inc. to increase its revenues by $2,070,325 or approximately 7.80%. The Company is directed to file amended tariff sheets for rates and charges in compliance with the terms of this Order. The rate increase that we authorize is effective for service rendered on and after September 5, 2000.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. UWI-W-00-1 may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order or in interlocutory Orders previously issued in this Case No. UWI-W-00-1. 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 day of September 2000.

DENNIS S. HANSEN, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

PAUL KJELLANDER, COMMISSIONER

ATTEST:

Myrna J. Walters
Commission Secretary

bls/O:uwiw001_sw5