

DECISION MEMORANDUM

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

FROM: JOHN HAMMOND

DATE: JULY 18, 2003

SUBJECT: IN THE MATTER OF THE APPLICATION OF CDS STONERIDGE UTILITIES, LLC FOR APPROVAL OF AN AMENDMENT TO ITS CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY TO INTERCONNECT WITH AND ACQUIRE THE SERVICE TERRITORY OF HAPPY VALLEY RANCHOS, INC. AND TO IMPLEMENT A SURCHARGE. CASE NO. SWS-W-03-1.

On March 17, 2003, CDS Stoneridge Utilities LLC (Stoneridge; Company; SU) filed an Application seeking Commission authorization to acquire the service territory of Happy Valley Ranchos, Inc. (HVR), a homeowners association water system, to complete an interconnection between the existing Stoneridge water system and the neighboring HVR system, to amend its Certificate of Public Convenience and Necessity (CPCN) to include the HVR customers within the Stoneridge service territory and to implement a surcharge on the rates for connecting HVR customers to service the debt that will be incurred to complete the interconnection project.

The Commission by Order No. 29254 suspended the Company's Application and ordered Stoneridge to continue charging only its current customers existing Commission-approved rates and charges until a Commission Order is issued accepting, rejecting or modifying the Company's Application and HVR customers are provided water service by Stoneridge. Order No. 29254 at 1. The Commission also issued Notice of Application, Notice of Public Workshop, Notice of Modified Procedure, and Notice of Written Comment Deadlines. *Id.* The Commission Staff submitted its written comments on July 7, 2003. Fourteen HVR customers also filed written comments.

THE APPLICATION

Stoneridge Utilities requests approval to interconnect its water system with the neighboring water system. HVR initiated discussions with SU regarding the possible interconnection of the two systems in order to obtain better quality water. The HVR system supply is of limited quantity and has experienced water quality problems in the form of high iron concentration that requires fairly expensive filtration. In comparison Stoneridge has two wells with large quantities of good quality water (600 and 800 gallons per minute), an existing chlorination system and a substantial amount of storage. After comprehensive negotiations between the two companies, SU agreed to interconnect subject to Commission approval and receipt of Idaho Department of Environmental Quality (DEQ) financing.

Stoneridge Utilities is working with DEQ for approval of the interconnection. It has also requested a loan from the State Drinking Water Revolving Fund to finance the engineering and construction of the interconnection. The Company has obtained the services of James A. Sewell and Associates consulting engineers to assist them with project engineering and agency review. The Company's engineering consultant filed a report with the Commission and DEQ entitled "CDS Stoneridge Utilities L.L.C. & Happy Valley Ranchos Water System Connection 2003 Engineering Report" on May 15, 2003. The engineering report provides the detailed engineering calculations for the design of the interconnection project and some minor HVR system upgrades. It also includes a detailed cost estimate for the project as well as a recommended recovery method for the construction costs. The report estimates the total project cost to be \$213,500. Stoneridge Utilities has requested an equivalent loan amount from the State Drinking Water Revolving Fund that is administered by DEQ to pay for all of the interconnection costs. The Company proposes to recover the financing costs by implementing a surcharge of \$12.65 per month from each customer benefiting from the interconnection. Presently that includes only the existing HVR water customers. However, the Company also proposed to apply the surcharge to any new customers connecting to the system downstream of the booster pump station serving the HVR system. The surcharge is intended to recover only the debt service costs (principal and interest) to amortize the State Revolving Fund loan over 20-years.

Once the interconnection is complete, the Company proposes to merge the operations of the HVR system with the Stoneridge system. Stoneridge will cancel the existing HVR rates

and charges and begin charging the HVR customers all existing Stoneridge Utilities approved rates and charges plus the surcharge. The Company is not proposing any changes in rates at this time to the existing Stoneridge Utilities customers. The following is a comparison of the existing HVR and SU rate schedules together with the surcharge proposed to collect the debt service costs:

Existing Happy Valley Ranchos

Base Charge	\$ 5.00	Existing loan surcharge	Monthly
Base Charge	\$ 24.00	including the first	20,000 gallons
	\$ 2.50	per 1000 gal for the next	10,000 gallons
	\$ 5.25	per 1000 gal for the next	10,000 gallons
	\$ 8.50	per 1000 gal for over	40,000 gallons

Existing Stoneridge Rates

Base Charge	\$ 14.00	Monthly
Commodity Charge	\$ 0.30	per 1000 gal

Proposed Happy Valley Ranchos Rates

Base Charge	\$ 14.00	Monthly
Commodity Charge	\$ 0.30	per 1000 gal
Proposed Surcharge	\$ 12.65	Monthly

Finally, Stoneridge stated that on March 28, 2003, a notice of its Application was provided to all customers on both water systems. A copy of that notice is attached to the Application as Exhibit H.

COMMENTS

1. Commission Staff

The Commission Staff reviewed the engineering report, performed an onsite investigation of the physical system, had lengthy discussions with DEQ, Stoneridge, its engineer, and held a public workshop at the Stoneridge Event Center in Blanchard, Idaho on June 23, 2003. Staff found the interconnection project is composed of approximately 3500 lineal feet of 8-inch transmission main, a fire hydrant, associated valves and fittings. Because the HVR system is higher in elevation, a duplex 150 gallon-per-minute 125-psi booster pump station is required between the two systems. The booster station is scheduled adjacent to the existing Stoneridge 315,000-gallon reservoir. Staff also found that the project also includes some minor system improvements to the HVR system. Staff noted the HVR system's existing 32,000-gallon storage tanks are to be cleaned and additional system flushing blow-offs are to be installed.

The project is scheduled to begin construction once the DEQ loan is finalized and the project receives agency approval. The initial project construction schedule anticipated completion by fall of 2003 but because of likely weather concerns a more realistic schedule will be final project completion in spring of 2004. Once the interconnection project is completed and water can begin flowing, the existing HVR well will be disconnected from the system and properly abandoned. Given the amount of iron residue and iron bacteria in the HVR system, additional tank cleaning and improved flushing ability provided by the interconnection will be needed to achieve water quality approaching that of the Stoneridge system. It may take as much as a year or more of working with the HVR system before the majority of the iron will be completely removed. Therefore, the two systems will remain isolated to avoid cross contamination.

Staff also found that the existing Stoneridge supply and storage appears to be adequate to serve both systems as Stoneridge is designed for a much larger customer base. Therefore, there remains excess storage and pumping capacity available to serve additional customers. If at some point in the future water production becomes a problem, Staff noted that the Stoneridge system is located over the Rathdrum Prairie Aquifer. This aquifer is known to contain huge reserves of high quality water. However, it is evident that the HVR system is not located over the same aquifer. HVR has attempted four times to find higher quality water and has been unsuccessful. Therefore, Staff believed the proposed interconnection and merger of the Stoneridge and HVR systems was the most practical and technically feasible method of providing a satisfactory water supply to the HVR homeowners.

Staff also found that the engineering report was professionally completed and the engineer has answered all of its questions regarding service supply and design. The proposed interconnection design appears capable of adequately serving the HVR system without detrimentally affecting service to the existing Stoneridge customers. DEQ has reviewed the proposed project and found it sufficiently favorable to recommend an interest rate reduction for the requested loan. DEQ is proposing an interest rate reduction to 2% from the traditional 3.75% revolving fund loan rate because the project consolidates two systems and it believes will provide significant public benefit. At the public workshop, customers in attendance spoke in favor of the merger and were generally in agreement with the surcharge rates proposed. Based

on the foregoing, Staff believed the project solves problems for the HVR customers without harming customers of Stoneridge.

In regard to the surcharge to cover the costs of the project Staff and Stoneridge agreed that the surcharge should neither harm nor benefit the Company. Staff recommended that it only be authorized to recover the project financing costs. In addition, Staff recommended that the actual surcharge be implemented only after construction is completed, the loan is closed, all costs are known and service is rendered to HVR customers. Even though Staff believed that all interconnection construction and financing costs should be included in the surcharge calculation, Staff cautioned the Company and its engineer to make every attempt to control construction costs. The proposed surcharge is the third surcharge estimate provided to the HVR customers and the costs have increased with each estimate. One customer at the public workshop expressed concern about the increasing costs but still supported the interconnection because of the significant benefits that resulted from the project. Staff recommended that the Company provide Staff with the results of the project construction bids and resulting surcharge estimate. The additional information should provide Staff with an additional degree of certainty for final construction costs. If costs have increased significantly from those proposed additional review might be warranted before construction costs are expended. Staff recommended that the Commission keep the case open and reserve final approval of the surcharge amount until construction is completed, the interconnection is operational and all financing costs are known and measurable.

Staff recommended that the surcharge should be charged to all customers taking service downstream of the interconnection between the Stoneridge and the HVR system.¹ Any new customers that connect to the HVR side of the system would also pay the surcharge. Staff recommended that these additional proceeds be used to prepay principal on the loan. Principal prepayment would help shorten the life of the loan and the surcharge. Staff believed that attempting to adjust surcharge rates with each new customer connection would be overly burdensome for the Company and would not provide sufficient benefit for the level of effort.

¹ The location of the interconnection between the Stoneridge and the HVR system is agreed to be the booster pump station adjacent to the existing Stoneridge concrete water storage reservoir.

Staff stated it will continue to work with the Company to establish proper accounting procedures for recording surcharge funds and expenditures. Staff will further assist the Company to properly record the improvements and revenues in the Company's annual reports.

The Commission in Case No. GNR-W-98-1, Order No 28206, approved the existing SU rates of \$14 per month plus \$.30 per 1000 gallons. These rates were based on 23 residential customers, 2 commercial customers, the condominium association and the golf course. The number of customers has grown slowly since the rate case. Currently there are 36 residential and 13 commercial customers and by interconnecting the HVR system, SU will add the 86 HVR residential customers. Water companies generally experience economies of scale with increases in number of customers and Staff believed that Stoneridge will likely experience unit cost savings as a result of the acquisition of these 86 customers. Therefore, Staff recommended that the Stoneridge rates be reviewed in two years from the time of the interconnection to ensure that the Company is not over earning from the addition of the HVR customers.

Staff has also reviewed the effect of the surcharge together with the existing Stoneridge rates on HVR customers. The existing SU rates are significantly below the existing HVR rates. Even with the proposed surcharge the cost to HVR customers may be less than their existing rates depending on customer usage. The greatest rate increase for HVR customers would be at a usage of 20,000 gallons per month. The increase at 20,000 gallons is less than \$4.00 per month for a much improved water supply. HVR customers using more than approximately 22,000 gallons per month would see a rate decrease, and those using from 7,800 to 21,700 would see an increase of less than \$4.00 per month.

The Commission sent individual notice of the proposed merger to each customer of both Stoneridge and HVR. A public workshop attended by 11 customers, representatives of the Commission Staff, both water companies and DEQ was held June 23, 2003 in Blanchard. Fourteen customers of the HVR water system have filed written comments. Those comments are now part of the official case record.

If the merger is approved, residents of HVR water system will become customers of Stoneridge Water Company. Staff found that Stoneridge Utilities is in compliance with the rules and regulations of the Commission, including the Utility Customer Relations Rules, (IDAPA 31.21.01.000), Utility Customer Information Rules, (IDAPA 31.21.02.000) and Small Water Company Policies, (IDAPA 31.36.01.000). The portion of the existing HVR homeowners

association by-laws applicable to the water system will be superceded by Stoneridge Utilities tariffs. Stoneridge has prepared a rules summary, which will be sent to all customers following approval of the merger. IPUC rules can be reviewed at the local office of Stoneridge Water Company, or on line at <http://www.puc.state.id.us/Rules.htm>.

Stoneridge's current tariffs can be found on the Commission's website. However, the current tariffs will not include the surcharge for HVR water customers until the Commission has determined the appropriate surcharge. Staff will work with Stoneridge to prepare a new tariff showing the surcharge for HVR water system customers at the completion of this case.

The Stoneridge development is operated and controlled under a number of different organizations. The parent company has added a strictly utility-limited liability company since the initial certificate was issued and has operated the utility solely through this company since its inception. Staff believed that this organization will facilitate the review of utility finances and potentially avoid the commingling of funds between the development company, golf course, or any other of the operations and the water utility.

Based on its review and comments Staff recommended:

1. The Commission approve Stoneridge's acquisition of the HVR water system.
2. The Commission approve the interconnection project and authorize debt financing from the State Drinking Water Revolving Fund when approved by DEQ.
3. The Commission reserve approval of the surcharge until all financing costs are known.
4. The Commission require Stoneridge to file the construction bid costs and revised surcharge calculation once bids are received.
5. The Commission authorize the use of existing Stoneridge Utilities rates for all former HVR customers and apply a surcharge only to those customers downstream of the booster pump station adjacent to the existing Stoneridge storage reservoir once service is provided to them.
6. The Commission require that all surcharge funds be used exclusively for the payment or prepayment of the State Drinking Water Revolving Fund loan.
7. The Commission change the name on Certificate No. 395 from CDS Stoneridge Associates-Land L.L.C. to CDS Stoneridge Utilities, L.L.C.

8. The Commission amend Certificate No. 395 to include the HVR's service territory within Stoneridge's certificated area.

2. Customer Comments

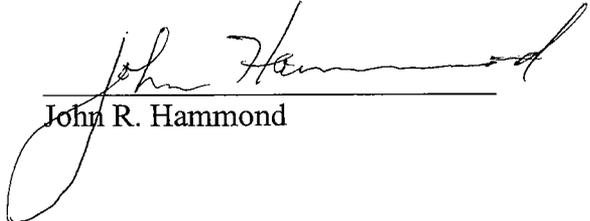
As stated previously, the Commission received comments from fourteen (14) HVR customers that would be affected by this project. The majority of these HVR commenters supported Commission approval of this project because they felt that they would receive better quality water from the Stoneridge system once the interconnection was completed. Several commenters also noted that more than 82% of all HVR water users supported merger with the Stoneridge system. Finally, a few commenters also were pleased that their rates would not increase significantly or at all after the project was completed and water service was provided.

Some commenters did raise concerns about the cost of the interconnection project. One commenter was opposed to paying for a fire hydrant that would only serve the lower tiers of the HVR development. Another requested a hearing to investigate the costs that would be incurred to effectuate this project. Although this customer/commenter supports the project she requests that the Commission investigate the costs.

COMMISSION DECISION

Does the Commission wish to consider the merits of Stoneridge's Application based on the written record or does it wish to grant the request of the HVR customer who asked for a hearing to investigate the costs of the interconnection project?

If the Commission wishes to consider the merits of this Application based on the written record does it wish to approve it based on the recommendation made by the Commission Staff?



John R. Hammond

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