

**BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION**

**IN THE MATTER OF THE APPLICATION OF )**  
**UNITED WATER IDAHO INC. FOR )** **CASE NO. UWI-W-00-1**  
**AUTHORITY TO REVISE AND INCREASE )**  
**RATES AND CHARGES FOR WATER )**  
**SERVICE. )** **ORDER NO. 28505**  
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**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<sup>2</sup>), 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<sup>2</sup> provided EM<sup>2</sup> 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 prudence 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	<u>\$ 136,118</u>
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	<u>\$ 102,106</u>
Total Adjusted Operating Expenses	\$17,059,284
Operating Income before Taxes	\$ 9,489,724
Idaho Income Tax	\$ 279,872
Federal Income Tax	<u>\$ 1,697,369</u>
Net Utility Operating Income	<u><u>\$ 7,512,483</u></u>

#### **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.

<u>Capital Structure</u>	
Debt	56.81%
Minority interest or preferred equity	.12%
Common equity	43.07%
Exh. 18, Sch. 6, p. 1; Exh. 108, Sch. 14	
<u>Cost of Debt</u>	7.52%
Exh. 18, Sch. 6, p. 2; Exh. 108, Sch. 14	
<u>Cost of minority interest</u>	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

<u>Component</u>	<u>Ratio</u>	<u>Composite Cost</u>	<u>Rate of Return</u>
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	<u>8.843%</u>
Net Operating Income Required	\$ 8,742,831
Net Operating Income Realized	<u>\$ 7,512,483</u>
Net Operating Income Deficiency	\$ 1,230,348
Gross-up factor	<u>1.683%</u>
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

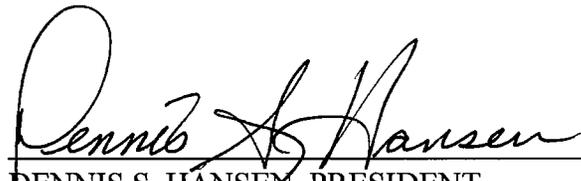
The Idaho Public Utilities Commission has jurisdiction over United Water Idaho Inc., a water utility, and its Application in Case No. UWI-W-00-1 pursuant to the authority and power granted under Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

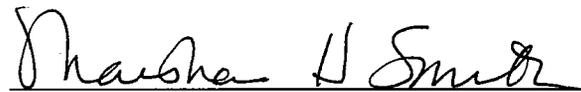
### ORDER

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 5<sup>th</sup> day of September 2000.

  
DENNIS S. HANSEN, PRESIDENT

  
MARSHA H. SMITH, COMMISSIONER

  
PAUL KJELLANDER, COMMISSIONER

ATTEST:

  
Myrna J. Walters  
Commission Secretary

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