

## DECISION MEMORANDUM

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

**FROM:** SCOTT WOODBURY

**DATE:** MAY 7, 2004

**SUBJECT:** CASE NO. UWI-W-04-2 (United Water)  
AGREEMENT FOR PURCHASE AND SALE – TERRA GRANDE  
PROPOSED RESCISSION OF AGREEMENT

On February 19, 2004, United Water Idaho Inc. (United Water; Company) and Barbara V. Child dba Terra Grande filed a Joint Application with the Idaho Public Utilities Commission (Commission) for an Order approving the purchase by United Water of water service properties owned by Barbara V. Child. (Application Exhibit 2 - Agreement for Purchase and Sale.) United Water now proposes to rescind the Agreement. Reference *Idaho Code* § 61-526; IDAPA 31.01.01.112.

### **Background**

The Terra Grande water system has been operating for over 50 years and provides water service under a flat rate to approximately 117 residential customers in the Terra Grande Subdivision in Ada County, Idaho. Terra Grande customers are presently served under a two-season flat rate. The summer rate for four months is \$26 and the non-summer rate for eight months is \$14, producing total annual per customer revenue of \$216.

As reflected in the Application, Barbara V. Child desires to convey the Terra Grande domestic water system to United Water because she wishes to retire from the water business and is unwilling to undertake the risks of continued operation arising from increasingly stringent water quality regulations, and increasingly complex operation and technical requirements. Because of its small size Ms. Child states that Terra Grande has experienced, and in the absence of the sale would continue to experience, difficulties in maintaining its system and obtaining adequate financing for operations, maintenance, and expansion.

On March 9, 2004, the Commission issued Notices of Application, Public Workshop and Modified Procedure in Case No. UWI-W-04-2. A public workshop was held on March 18, 2004. The comment deadline was April 2, 2004. Comments were filed by Commission Staff and a number of Terra Grande customers. Reply comments were filed by United Water.

### **Staff Analysis**

*Investigation of the Terra Grande System.* Staff contacted the Idaho Department of Environmental Quality (DEQ) to ascertain the status of the existing wells and water quality on the Terra Grande system. DEQ reports that Terra Grande has not been monitoring and testing the water according to the DEQ required schedules. There is no water treatment program on the existing Terra Grande system. One of the four wells included in the Terra Grande water system has not been used in a number of years due to the poor quality of its water. A second well currently exceeds the maximum radiological contaminate levels. A number of other contaminates are presently borderline acceptable and may require treatment in the near future. DEQ has required a number of repairs to the Terra Grande system which have not been made including: 1) Well #3 - seal the well head and holes in the casing; 2) Wells # 2 & 3 - extend well casing vents 18" above floor and re-screen; 3) Well # 3 - install a flow meter; 4) Well #1 - add a sight glass on the pneumatic tank. The estimated cost of these improvements is \$10,000. The cost of installing an ion exchange unit on Well #2 to remove the radiological contaminates is estimated to be about \$100,000. This assumes there is adequate land available for installing the ion unit and that cannot be assured at this time. Well # 2 sits on a parcel of ground that is only twelve feet by twelve feet (12' x 12'). The installation of disinfection equipment on all three wells is estimated to cost about \$7,500. Well #4 must be properly sealed and abandoned to Idaho Department of Water Resources' standards at an estimated cost of \$2,000. The pneumatic tanks on the other three wells are aged and in need of replacement. When replaced, the DEQ will require that the tanks be relocated above ground rather than in existing below ground vaults. This will require the reconstruction of the well houses to accommodate the tanks. The cost of tank replacement and reconstruction of the well houses is estimated to be \$105,000. The Terra Grande system has no reservoir and has no ground available for construction of a reservoir. A stand-by generator for the largest of the three wells, though not required, would cost approximately \$25,000 and would assure minimum domestic service during a period of extended power interruption. In addition to the system improvements, the DEQ will require accelerated

water quality testing due to the failure of Terra Grande to perform the tests at the required intervals and because contaminate levels identified are marginal. The first year's accelerated testing expense is expected to be about \$8,000. Those test results will determine the next year's testing requirements/costs. DEQ has delayed enforcement action toward Terra Grande awaiting the outcome of this proposed sale.

The expenses and improvements necessary to bring the existing Terra Grande system into DEQ compliance total approximately \$250,000. The owner of Terra Grande, Barbara Child, is a sole proprietor. If she were to keep the system, a significant increase in water rates would be needed to cover the projected system improvement costs. Staff estimates that these improvements and expenses would require an additional revenue requirement of \$42,200 just to recover depreciation expense, a 10% return on the \$250,000 investment and incremental testing expenses. This translates to an annual cost of \$577.00 for each of the 117 customers, an increase of \$361 or 167% over their current rate of \$216 per year.

***Subsequent Developments.*** Staff learned from United Water's attorney on March 25, 2004, that the quality and soundness of the existing Terra Grande distribution system within the subdivision is not as represented by Terra Grande. The City of Boise is installing a new sewer line within the subdivision. The contractor on the project has, due to poor location information from Terra Grande, cut several service lines and uncovered leaks on the water system. The contractors are not being reimbursed for their repair costs by Terra Grande. The contractor is unwilling to absorb these costs and the City is considering halting the sewer project until suitable arrangements can be made for reimbursement of costs incurred and better location information is made available. Terra Grande has proposed the sewer project be halted until after United Water takes over the system and has metered services installed that will make location easier. As a result of the sewer excavation, United Water has had the opportunity to observe directly a water main in Penninger Street that was characterized by Terra Grande as a four inch (4") AC (asbestos concrete) line. The line is actually two inch (2") galvanized iron pipe that is in very poor, fragile condition. This 700-foot line may have to be replaced before United Water can complete the interconnection to its own distribution mains. This information brings into question the accuracy of the information provided on the remainder of the existing Terra Grande distribution system. If this line is indicative of the general condition of the remainder of the existing Terra Grande distribution system, a total of more than 5,600 feet of distribution line may

require replacement. The cost of replacing existing Terra Grande distribution lines with four to six inch mains would be an additional cost to United Water not included in the original Application. No accurate information is available at this time regarding estimates of either the magnitude or cost of any required distribution line replacements that may be required.

### **Staff Recommendations**

Given the poor water quality, the poor reliability and the high cost of restoring the existing Terra Grande system to an adequate level of service, Staff was unable to support payment of the \$47,000 purchase price. In making this recommendation Staff acknowledges that the estimated revenue the Company expects to receive from Terra Grande customers at current United Water rates will not be sufficient to acquire the system and perform the facility upgrades necessary to provide adequate service. Based upon current estimates, the cost for Terra Grande and its customers to restore the system on a stand-alone basis far exceeds the cost required for interconnection with United Water. In Staff's opinion, it is unreasonable for United Water to pay for a water system in such a state of disrepair. Even acquisition at no cost will likely result in a revenue deficiency that will require subsidy if included in Company rates. Staff cannot support any payment to Barbara Child for the Terra Grande water system or recovery by United Water of any such payment from existing customers. Staff believes with the elimination of the \$47,000 purchase price, acquisition by United Water is in the public interest and should be approved. Additional cost information should be submitted by the Company to determine the potential for recovery through rates and the size of subsidy that may be required in the future.

Finally, should the owner of Terra Grande refuse transfer of the water system, Staff recommends that a Certificate of Public Convenience and Necessity be immediately issued and that Terra Grande be brought under the regulatory jurisdiction of the Commission. Terra Grande should then be directed to make whatever system improvements are necessary to provide adequate service and to bring the system into compliance with DEQ standards. Terra Grande should immediately be made subject to all of the Commission's existing rules and regulations. Terra Grande should be informed that no change in rates may be made without prior approval of this Commission.

### **Proposed Rescission of Agreement**

The Purchase and Sale Agreement in this case called for among other things an agreed purchase price of \$47,000. Pursuant to the Agreement, United Water was granted a due diligence period during which the Company would conduct further investigation regarding the quality and soundness of the seller's water distribution system. The Company's obligation to close the transaction was contingent upon satisfactory conclusion of its due diligence investigation. As a result of its investigation the Company learned that the system was not in good working order and was not in conformance with applicable laws, rules and regulations as represented and warranted by paragraph 5T of the Agreement. United Water sought to eliminate the \$47,000 agreed purchase price based on additional unforeseen investment required to connect Terra Grande customers to the United Water system. Staff is informed that Ms. Child finds the Company-proposed elimination of the \$47,000 cash payment to be unacceptable. United Water's proposal was rejected and the Company has tendered a proposed Rescission Agreement and Settlement for signature.

### **Commission Decision**

For reasons discussed above, United Water is seeking to rescind the Purchase and Sale Agreement. Staff based on its investigation represents that the Terra Grande Water System is being operated in such a manner as to bring it within the jurisdiction of the Commission under Title 61, Idaho Code. Staff recommends that a Certificate of Public Convenience and Necessity be issued to Barbara V. Child dba Terra Grande Water System. Staff recommends that Terra Grande be directed to make whatever system improvements are necessary to provide adequate service and to bring the system into compliance with DEQ standards. Staff recommends that Terra Grande be immediately made subject to all the Commission's existing rules and regulations. Staff recommends that Terra Grande be informed that no change in rates is to be made without prior approval of the Commission following Staff investigation and report.

---

Scott D. Woodbury

b1s/M:UWIW0402\_sw2