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IDAHO PUBLIC  
UTILITIES COMMISSION

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION  
OF UNITED WATER IDAHO INC., FOR AN  
AMENDMENT TO ITS CERTIFICATE OF  
PUBLIC CONVENIENCE AND NECESSITY  
NO. 142 AND FOR AN ACCOUNTING ORDER.

Case No. UWI-W-04-03

**UNITED WATER IDAHO INC.  
REPLY COMMENTS AND REQUEST  
FOR ORAL ARGUMENT**

**INTRODUCTON**

In this proceeding United Water Idaho Inc., (“United,” “the Company”) seeks authority to remove the Carriage Hill Subdivision from it certificated service area by transferring the facilities that serve the subdivision to the City of Nampa. United has negotiated a Purchase and Sale Agreement with the City, which is subject to Commission approval. United also seeks an accounting order with respect to the distribution of the sale proceeds.

The Commission Staff (“Staff”) in Comments filed September 27, 2004, concludes that the transfer is consistent with the public interest because the City has adequate ability to serve, interconnection with the City will improve the supply capacity for the system, and customers will obtain service at rates less than those charged by United. (Staff Comments page 4). United concurs in this portion of Staff Comments.

With respect, however, to distribution of the sale proceeds, United and Staff are in disagreement. In its Application, United sought an accounting order that would permit distribution as follows:

Pursuant to the Agreement the purchase price for the sale of the domestic water system is \$375,000. Subject to final adjustment at closing an amount equal to approximately \$339,000 shall be paid to United Water Works to discharge the accrued interest and principal owing pursuant to the Build-Design Promissory Note, above referenced. An amount equal to approximately \$36,000 shall be paid to United. (Application, paragraph XII, page 4).

In its Comments, Staff offers alternative proposals (Staff Comments page 5). In the first section of these Reply Comments, United demonstrates that the Staff proposals are contrary to law and sound policy.

In addition to the central issue of proceeds distribution, Staff Comments contain other factual and analytical errors, which are discussed in the second section of these Reply Comments.

**STAFF'S PROPOSALS FOR PROCEEDS DISTRIBUTION ARE CONTRARY TO LAW AND SOUND POLICY.**

Staff's analysis of the distribution issue is founded on the Idaho Supreme Court Case of *Boise Water Corporation v. Idaho Public Utilities Commission*, 99 Idaho 158, 578 P.2d 1089 (1978). There, the Court acknowledged that in limited circumstances ratepayers may obtain an equitable interest in depreciated utility property that may be recognized upon sale of that property. Although, on the specific facts of the case, the Court reversed a Commission order that purported to award to ratepayers the proceeds from the sale of non-depreciable real property. "The record is devoid of any justification for applying the benefit of the appreciation in value of the Hull's Gulch land to ratepayers rather than to shareholders." 99 Idaho at 162. The Court held that ratepayers do not have any equitable interest in property with respect to which they have not paid depreciation

through rates. Accordingly, it is error to distribute to ratepayers the proceeds of sale of non-depreciated property.

It is also important to note that rate payers' equitable interest in the proceeds of sale of depreciated property recognized in *Boise Water* is a narrow exception to the well established general rule that property devoted to public utility service is privately owned by the utility, not its customers. This was first articulated by the United States Supreme Court in *Board of Public Utility Commissioners v. New York Telephone Co.*, 270 U.S.23, 70 L.Ed 808 (1926):

Customers pay for service, not for the property used to render it. By paying bills for service [customers] do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. 271 U.S. at 32.

Based on the *New York Telephone* rule, courts of other states have uniformly held that ratepayers do not have any interest in the proceeds of sale of non-depreciated property.

*Maine Water v. Public Utilities Commission*, 482 A.2d 443 (Me. 1984); *City of Lexington v. Lexington Water Co.*, 458 S.W.2d 778 (Ky. App. 1970); *Philadelphia Suburban Water Company v. Pennsylvania Public Utility Commission*, 427 A.2d 1244 (1981).

It is undisputed in this case that the net sales proceeds (after adjustments to make the company whole, and with a small exception discussed hereafter) represent proceeds from property that was either contributed or advanced by customers or the developers. Ratepayers do not pay depreciation on advanced or contributed property, nor do customers pay a return on advanced or contributed property. Rates with respect to advanced or contributed property do not include either a return of or a return on a company investment in that property.

Contrary to the clear precedent of *Boise Water* and established law, Staff's first proposal would split the sale proceeds equally between ratepayers and shareholders. Staff's third proposal is a variation on the first, splitting proceeds from contributed property 50-50 between ratepayers and shareholders and allocating 8.849% of the proceeds from depreciable assets to ratepayers. Staff's second proposal is discussed separately below.

These proposals are wrong as a matter of law and the Staff is asking the Commission to do precisely what the Supreme Court in *Boise Water* said it could not do:

...[N]ot having paid the cost of purchasing nondepreciable property, ratepayers are not entitled to reap the rewards or losses on its sale or other transfer. 99 Idaho at 162.

Staff mis-interprets the *Boise Water* holding when it says, "The general rule of the *Boise Water* case should represent the minimum interest, not the maximum interest, the ratepayers have in the sale proceeds when the assets are contributed." (Staff Comments page 8). The direct language of *Boise Water* is expressly to the contrary.

Even assuming, without admitting, that a policy of splitting sale proceeds is legally permissible, it is bad policy. This is illustrated by the case of *North Carolina ex. Rel. Utilities Commission v. Public Staff*, 472 S.E.2d 193 (1996). There, the North Carolina Commission had previously pursued a policy of splitting sale proceeds, but reversed itself, finding that proceeds splitting was not in the public interest. The North Carolina Court affirmed, and adopted the Commission findings that:

...such a policy, contrary to the public interest, serves as a disincentive to sell and may thereby discourage and impede beneficial sales to municipal and other government-owned entities.

With the benefit of hindsight the Commission can now see that the policy to split gains or losses on sales of water systems had a negative impact on the public good.

A policy of gain splitting for sales of water systems may undermine the achievement of economies of scale and encourage inefficient operations.

The Commission should not impose economic barriers to the orderly transfer of water systems to municipal entities.

If economic incentives are removed so that succession of ownership becomes inadvisable, customers are denied those benefits. If companies like CWS are prevented from retaining the gain on sale a substantial incentive is removed for those companies to buy systems from developers or small, undercapitalized operators in the first instance. At a minimum, the sale price is artificially increased above the fair market based price to adjust for the payment of part of the gain to customers. The result is harm to consumers because the natural progression of transfer of ownership to the most efficient provider is disrupted. These harmful consequences are clearly not in the public interest. 472 S.E.2d at 196—197.

While Staff's intuitive reflex to capture some benefit of the sale for ratepayers in the short term is not surprising, it does not lead to good overall policy for the reasons articulated by the North Carolina Court of Appeals.

And, the policy considerations articulated in *North Carolina* are present here. If Staff's proceeds allocation recommendations are accepted, the transaction will likely fail and a transfer, which Staff otherwise agrees is in the public interest, will likely not occur.

#### **OTHER ANALYTICAL SHORTCOMINGS**

If, based on the foregoing, the Commission declines to accept Staff's recommendations and approves the transaction as originally proposed by United it will not be necessary for the Commission to consider all of the items discussed hereafter. They are included here for the sake of thoroughness.

## **Risk Analysis**

Putting aside the legal and policy problems to Staff's proposed allocations, Staff's first proposed method, based on comparative risk is analytically flawed. Under this method, Staff identifies various risk elements—including increase in rate base, depreciation, increased operation and maintenance costs—and suggests that proceeds be allocated in relation to how the risks are borne by each party. (Staff Comments page 7). Without explaining the basis of its analysis, Staff simply concludes, "...Staff believes the relative risks of the ratepayers and UWI are very similar and approximately equal. Thus, it is reasonable that the allocation of the sale proceeds should reflect the similar and equal risks of each party. To the extent risks are equal, then the net sale proceeds should be divided equally". (Staff Comments page 7).

As noted, Staff does not explain the basis of its "equal risks" conclusion, but the conclusion, whatever its basis, does not withstand scrutiny, for at least two reasons.

First, the non-contiguous expansion program was specifically designed to insulate United's general body of ratepayers from speculative risk. All the investment, whether distribution or source of supply, is provided either through advances or contributions. United does not make investments, through refunds and meters, until there is revenue to support the investment.

Second, as Staff notes in its Comments (page 2) the Carriage Hill project was constructed after the Commission's rate Order in United's last general rate case. If all goes as planned, the Carriage Hill's investment will be off United's books before the Commission Order in the next general rate case. Thus, United's customers are not currently paying rates that include recovery of any Carriage Hill investment.

In short, United's customers are currently exposed to zero risk, and under a risk-reward analysis, they would not be entitled to a share in the proceeds.

### **Depreciation Ratios**

Staff's second proposed allocation method develops a ratio of accumulated depreciation (\$2,334) compared to net book value (\$26,387) and results in a sharing percentage for ratepayers of 8.849% of the net sales proceeds.

This method has the possible virtue of not offending the rule of *Boise Water*, but it does offend the *North Carolina* policy considerations. Sharing of sale proceeds creates disincentives and hurdles for efficient transactions that are in the public interest, as this one admittedly is.

And, as noted above, United's current rates, having been established prior to the Carriage Hill investment, however minimal, do not include a recovery of that investment.

### **Involvement of United Waterworks**

Throughout Staff Comments, Staff is critical of the involvement of United Waterworks in the initial financing of the project and of UWW's receipt of some portion of the sale proceeds. The Affidavit of Gregory P. Wyatt, filed herewith, responds to these concerns on a point-by-point basis. More broadly, it seems that Staff's generalized animosity toward any transaction involving an affiliate causes Staff to overlook the benefits of the transaction as proposed—The Carriage Hill customers obtain an immediate second source of supply and lower rates; United's general body of customers are indifferent; litigation between UWW and Carriage Hill is avoided; a debt that is owing is satisfied; the City of Nampa can expand its system to meet growth in a systematic fashion.

## CONCLUSION

For the reasons cited herein, United respectfully requests that its Application be approved.

## REQUEST FOR ORAL ARGUMENT

United respectfully requests the opportunity to present oral argument with respect to its Application, the Staff Comments and these Reply Comments.

Respectfully submitted this 17 day of October, 2004.

UNITED WATER IDAHO INC.

By:   
Dean J. Miller  
*Attorney for Applicant*