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Idaho Public Utilities Commission
Office of the Secretary
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NOV 30 2004

Boise, Idaho

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE IN THE STATE OF IDAHO	**Case No. UWI-W-04-04**

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

DIRECT TESTIMONY OF JEREMIAH J. HEALY

Q. Please state your name and business address?

A. Jeremiah J. Healy, 8248 West Victory Road, Boise, Idaho 83709.

Q. By whom are1 you employed and in what capacity?

A. I am employed by United Water Idaho Inc. ("United" or "the Company") in the capacity of Coordinator of Planning and Rates.

Q. How long have you been employed by United Water Idaho?

A. I have been employed by United Water Idaho or United Water Management and Services Company since February 1980.

Q. Briefly describe your responsibilities during your tenure.

A. As a Staff Accountant with the Central Region Office in Harrisburg, PA until April, 1982 I performed general accounting, prepared federal and state tax returns and public utility commission annual reports. In May, 1982 I became an Internal Auditor responsible for conducting financial and special audits on regulated and non-regulated subsidiaries. From September, 1985 until December, 1989 I was Accounting Supervisor for United Water Idaho. In this capacity, I was responsible for accounting and planning functions. In January, 1990 I became Financial Coordinator for the Western Region of General Waterworks responsible for accounting, budgeting and strategic planning for five water and/or wastewater utilities. From August, 1993 until October, 1994 I was Director of Rates at United Water Management and Services Company. In this capacity I prepared rate filings for various utility subsidiaries. In November, 1994 I assumed my current position.

Q. What is your educational background?

A. I was granted a Bachelor of Science degree with a major in accounting from the University of South Carolina in May, 1977.

Q. Before what regulatory commissions have you appeared and presented expert testimony?

A. I have testified in various proceedings before the Idaho Public Utilities Commission ("IPUC") and I have submitted written testimony before the regulatory bodies in Illinois and Arkansas.

Q. What is the test year United Water is utilizing in this proceeding?

A. The Company is using the twelve-month period ended July 31, 2004. Normalizing and annualizing adjustments have been made to the test period and known and measurable adjustments have been made to revenue, operating expense and rate base elements through May 31, 2005. The Company is utilizing a year end rate base in this proceeding, as is consistent with past IPUC decisions in Cases UWI-W-00-01, UWI-W-97-6, UWI-W-96-3, BOI-W-93-3 and BOI-W-93-1.

Q. In connection with the Company's present application for an increase in rates and charges, what is the scope of your participation and testimony?

A. My participation and testimony covers both operating expenses and rate base. I have analyzed the Company's books and records and prepared the necessary accounting exhibits to adjust operating expenses. I also have developed and will present testimony on rate base for the Company, integrating the capital projects discussed by Witness Rhead. Both operating expenses and rate base are predicated on a test year ending July 31, 2004. Also included are known and measurable adjustments that will occur prior to the time that new rates will become effective in this case, which was estimated to be May 31, 2005. In the early stages of planning the case, this was the best estimate for the in-service date of the Columbia Water Treatment Plant ("CWTP"), and all pro forma adjustments were developed consistent with that date. The Company continues to anticipate that the facility will be in-service on or before May 31, 2005. However, the Company was not able to properly prepare and file the rate case in the period of time which would have been necessary to have this date and the end of the Commission's suspension period coincide. The pro forma adjustments are all projected to May 31, 2005, the originally planned in-service date for CWTP, but because of the time necessary to prepare the filing, this will not coincide with the effective date of the new rates as originally planned, unless it is possible to resolve the case by then.

Q. Please generally describe the approach you have taken in preparing the exhibits for operation expenses.

A. For operation and maintenance expenses, I have relied on information and data produced within the Company, and my own investigation thereof, as the basis for my adjustments. For depreciation, amortization of plant held for future use, amortization of utility plant acquisition adjustments, operating taxes and income taxes, supporting details are shown which provide the basis for these adjustments.

Q. Have you prepared from the Company's books and records a series of exhibits depicting the Company's balance sheet and operating income statement for the test year ended July 31, 2004?

A. Yes, I have prepared Exhibits Numbers 4 and 5 illustrating the Company's Balance Sheet (Exhibit No. 4) and Operating Income Statement Per Books (Exhibit No. 5). Both of these exhibits are based upon results for the test period.

Q. Have you prepared an exhibit that indicates the pro forma operating income for the Company at existing and proposed rates?

A. Yes. I have prepared Exhibit No. 2, which is titled "Statement of Operating Income Per Books and Pro Forma under Present and Proposed rates for the year ended July 31, 2004". I have also prepared Exhibit 3 Summary identifying the individual adjustments, except for revenue adjustments discussed by Witness Gradilone, found on Exhibit 2.

Column 1 of Exhibit 2 identifies the schedule on Exhibit 3 that details the test year pro forma adjustments indicated in Exhibit 2, Column 2. Column 2 indicates the elements of operating income: operations and maintenance expense, depreciation and amortization expense, taxes other and income taxes. The amounts therein are per books, as shown in Exhibit No. 5. Column 3 shows a summary of test year adjustments made to revenues and expenses. The adjustment to operating revenue shown on line 4 will be explained by Witness Gradilone. The adjustments to operation and maintenance expenses, summarized on line 6, are detailed in Exhibit No. 3 Summary, Schedule 1 and they will be explained in conjunction therewith. The adjustments to depreciation expense, amortization of plant held for future use and amortization of utility plant acquisition adjustments summarized on lines 7, 8 and 9 are detailed in Exhibit No. 3 Summary, Schedule 2, pages 1 to 4, and will be explained in conjunction therewith. The adjustments to operating taxes summarized on lines 11 and 12 are detailed in Exhibit No. 3 Summary, Schedule 3, pages 1 to 4, and will be explained in conjunction therewith. Column 4 shows the adjusted operating income at existing rates for the test period. Column 5 indicates the adjustments to operating revenues, operation and maintenance expenses, and income taxes under the increased rates proposed herein. The adjustment to operating revenues of $6,767,870 was computed based on an 8.93% rate of return on rate base. Column 6 shows the adjusted operating income necessary to produce the requested return. The income taxes shown on lines 18 and 19 were computed as indicated on Exhibit No. 3 Summary, Schedule 4, and will be explained in conjunction therewith.

Q. Returning to Column 5 of Exhibit No. 3 Summary, please explain the adjustments to operating expenses?

A. Operation and maintenance expenses have been increased by $1,933,193 (Exhibit 3 Summary, line 35). Depreciation and amortization expense have been increased by $1,598,479 (Exhibit 3 Summary, line 50). Property taxes and payroll taxes have been increased $72,522 (Exhibit 3 Summary, line 57). Federal income taxes have decreased $1,453,467 and State income taxes have been decreased by $680,427 (Exhibit 2, lines 18 & 19).

The detailed support for the operation and maintenance expense adjustments are shown on the four Schedules following the Exhibit 3 Summary. Schedule 1, pages 1 to 34, provides detail for adjustments made to operation and maintenance expense. Schedule 2, pages 1 to 4, provides detail for adjustments to depreciation and amortization expense. Schedule 3, pages 1 to 4, provides detail for adjustments to property and payroll taxes. Schedule 4, page 1 provides detail for adjustment of State and Federal income tax expense.

Q. Please describe the various normalizing and annualizing adjustments, as well as known and measurable adjustments, made to operation and maintenance expense.

A. <u>Adjustment No. 1</u> increases payroll expense by $232,555 (Schedule 1, Page 1). This adjustment reflects anticipated pay increases for salaried employees to be effective April 1, 2005. For

Bargaining Unit employees, the pay rates used reflect those that will become effective April 1, 2005 as called for in the current contract. For all employees, total hours by employee, covering the period August 1, 2003 through July 31, 2004, were determined and applied to the contractually obligated (for Bargaining Unit employees) and anticipated pay rates (for non-BU employees, anticipated to be 3.5%). During the test year, the Company had a fully staffed payroll roster of 88 employees. Three new positions are proposed in the pro forma period.

Q. Please identify the three staffing additions incorporated into the Company's filing.

A. The Company proposes to add one Chief Operator, one Operator, and one Public Relations Manager, to its current complement of staff. All staff additions are anticipated to occur prior to hearings in this proceeding.

Q. Please explain the rational and need for the additional staff.

A. The two operations positions, Chief Operator and Operator, are required in order to maintain operations and maintenance activities related to the Company's increased source of supply, pumping, and treatment facilities. Treatment and well system technical requirements have steadily increased due to the addition of chlorine generation and greensand treatment facilities within the system as well as the addition of the Columbia Water Treatment Plant (CWTP). The technical requirements include operation and maintenance, calibration and troubleshooting of the 28 chlorine generation units and two greensand treatment facilities at wells, plus chlorine generation at the Marden Treatment Plant. The Columbia Water Treatment Plant, with its membrane filtration and chlorine generation processes adds an additional and unique set of technical requirements of its own.

The Chief Operator will coordinate and support the activities at Marden, Columbia, and the two greensand facilities, and will also work as a functional operator at facilities throughout the system. The Operator position provides staffing needed to support the operations and maintenance requirements of all water supply, pumping and treatment facilities throughout the system.

The Public Relations Manager is required to enable the Company to effectively participate in the business and political community on a wide range of issues that are vital to the business. Some of these include quality of service, customer communications, community involvement, legislative issues, media relations and others.

A test year based ratio of labor charged to operation and maintenance expense was applied to total labor to determine the O&M component.

<u>Adjustment No. 2</u> increases the Company's contribution to the 401(K) thrift plan by $1,321 (Schedule 1, Page 2) based upon historical participation rates in this supplemental pension plan. The Company

payment into the plan of $91,477 represents partial employer matching of employee contributions into the plan. The Company matches 50% of an employee's contributions up to a maximum of 3% of regular annual pay for all participating employees.

<u>Adjustment No. 3</u> increases the cost of providing medical and dental care, vision care, long-term disability insurance and group term life insurance coverage to employees by $148,338 (Schedule 1, Page 3). The pro forma cost of providing the various coverages was applied to the July 2004 authorized level of employees plus the three new positions discussed earlier. Contributions from all employees offsetting Company costs were calculated based on the current level for various coverage options.

Q. Will the Company's late fall 2004 open enrollment period have any impact on the pro forma cost of Medical Care?

A. Yes. As this information becomes available, the cost of providing medical and dental coverage will be updated to reflect the most current available information.

Q. Please continue with your discussion of adjustments to operations and maintenance expense.

A. <u>Adjustment No. 4</u> increases test year expense by $12,279 for employee pension cost (Schedule 1, Page 4). This adjustment reflects the estimated 2005 Financial Accounting Standards Board (FASB) 87 cost as developed by the Company's actuary for Bargaining Unit and non-Bargaining Unit employees of the Company and is consistent with the standard treatment afforded pension expense by the Idaho Public Utilities Commission.

Adjustment No. 5 decreases test year expense by $145,345 for the normalization of PBOP (Post Retirement Benefits Other Than Pension) Schedule 1, Page 5. The pro forma level of expense represents the actual 2005 FAS 106 expense as developed by the Company's actuary plus a 20-year amortization of the deferred portion of FAS 106 expense.

Adjustment No. 6 decreases test year expense by $52,956 for the normalization of payroll overheads chargeable to other than Operations and Maintenance expense (Schedule 1, Page 6). The relationship of employee benefit expense to workday payroll dollars is 63.03%. Added to this percentage is 16.28% for non-work days, which, when combined, totals 79.31%. When 79.31% is applied to pro forma non-O&M payroll, the result is a pro forma overhead credit of $912,751. This is $52,956 larger than the test year overhead credit of $859,795.

Adjustment No. 7 (Schedule 1, Page 7) increases test year expense by $105,526 for the amortization of deferred early retirement cost. In Case No. UWID-W-00-1, Order No. 28505, the Commission allowed the Company to recover, over 5 years, $761,081 of deferred benefit cost associated with four employees who participated in the Company's 1999 voluntary early retirement program (ERP). The program was offered to all employees who met plan age and length of service requirements. In year 2000, the Company again offered an ERP opportunity to employees who met program requirements. Six additional employees took advantage of the opportunity. The Company recorded an additional $1,250,617 in deferred benefit cost. (Notice was sent to the Commission regarding the recording of this expense deferral). In the current case, the Company is requesting recovery of the small un-amortized balance of the original ERP ($38,052) along with the year 2000 ERP cost for a total of $1,288,669. United Water requests a five-year amortization period, resulting in annual expense of $257,734. The test year level of expense was $152,208 leading to an incremental adjustment of $105,526.

Q. What was the Company's rationale for offering ERP?

A. The intent of the ERP offering was to entice employees to retire early. The Company expected to and did benefit in several ways from these programs. The economic and efficiency benefits generated flow through to our customers at the time rates are determined, and, by enabling the Company to extend the period between rate-increase requests.

Q. Please explain the benefits realized by the Company and its customers.

A. The ERP program allowed the Company to reduce the size of its workforce, resulting in substantial labor and benefit savings. Coupled with the smaller workforce, United Water re-aligned responsibilities and increased productivity and efficiency. I will illustrate this point in several ways: First, the Company's ratio of customers per regular employee has increased from 608 in 1997 and 605 in 1998 to 845 pro forma as of May, 2005. This represents an increase of over 39%. Secondly, the Company has controlled its operations and maintenance expense, based on the information provided in the IPUC Annual Report, to a 3.81% average annual increase from 1997 through 2003. If employee benefit costs, including the ever-rising cost of medical coverage are removed, this percentage drops to 2.24%. The ERP and other cost saving practices have helped the Company maintain expense growth at this level while, at the same time, the water system has experienced the addition of nearly 10,000 new customers.

Adjustment No. 8 (Schedule 1, Page 8) increases test year expense by $49,751 for the amortization of deferred enhanced severance program expenses. In 2002 and in 2003, the Company offered an enhanced severance package (ESP) that was intended to entice employees to take advantage of other employment opportunities. Similar to the ERP discussed above, the intention was to reduce cost and increase efficiency. A total of four employees took advantage of the ESP at a cost of $248,753, the largest component of which was severance pay. The Company requests a five-year amortization amounting to $49,751 annually. The test year contained no ESP cost, other than an accounting miscode corrected in adjustment 29.

<u>Adjustment No. 9</u> increases Purchased Water expense by $87,528 (Schedule 1, Page 9). The Company, in addition to owned water rights, has long and short-term lease and rental agreements with various entities to use surface water rights. The expense increase is driven by the opening of the Columbia Water Treatment Plant, which will necessitate the use of 3,000 Acre Feet of additional water at an estimated $26 per AF.

<u>Adjustment No. 10</u> increases test year expense by $6,091 for tank painting amortization (Schedule 1, Page 10). The Company has historically received a ten-year amortization of this expense in accord with prior Commission orders. In addition to existing amortizations that began amortization in the 2000 case, two additional tanks have been painted in the interim period, increasing the annual level of expense.

<u>Adjustment No. 11</u> increases purchased power cost by $514,265. (Schedule 1, Page 11). The 41% increase is due to three major factors. First, the Columbia Water Treatment Plant and its associated pumping station will require an annual level of power expense of $284,400. This estimate has been developed by Witness Rhead and provided to me. The CWTP and associated raw water pumping station will be consumptive power users to the extent of $236,400 of the above $284,400. The balance of $48,000 is the annual expense of maintaining a redundant power supply. Secondly, the Company will no longer be

subject to the deferred accounting order issued by the IPUC in Case UWI-W-01-02, Order No. 28800, once proposed rates go into effect in this case. Due to the power crisis suffered by the Northwest in 2001 and 2002 and the extraordinary impact the crisis had on Idaho Powers rates, through the operation of the Power Cost Adjustment mechanism, the IPUC granted the Company permission to establish a deferral account for incremental cost related to "…recent and future PCA related increases in Idaho Power Company electric power rates beginning May 1, 2001….". The Company deferred to its balance sheet the impact of the higher power cost. The balance of this deferred account as of the end of the test year is $1,363,240 and it is expected to rise to over $1,550,000 by May 31, 2005. The recovery in customer rates of the deferred expense is discussed in Adjustment No. 12 my testimony. As of the effective date of the new rates put in place in this case, the Company will revert to full expensing and recovery of power included in customer base rates. No deferral of expense will be necessary. Third and finally, in the summer and fall of 2004, Idaho Power was granted its first base rate increase in approximately ten years. Idaho Power tariff rates effective July 28, 2004 for Schedule 7 & 9 usage, as well as schedule 19P "time of use" rates to be effective December 1, 2004 (applicable to United's Marden WTP) were applied to test year power consumption to determine pro forma expense. In a separate adjustment, United reduces power expense due to operational changes in the system once CWTP comes on-line.

Adjustment No. 12 increases operations & maintenance cost by $516,667 due to the previously mentioned deferred treatment of extraordinary power cost incurred from May 1, 2001 through the effective date of rate implementation in this case (Schedule 1, Page 12). The Company deferred power cost related to Idaho Power's PCA mechanism above the level of power expense established in Case UWI-W-00-1, Order No 28505, dated September 5, 2000. United has maintained detailed accounting records of the deferral, which includes a modest carrying charge based on the annual customer deposit interest rate (currently 1%), as established by the IPUC. The three-year amortization period was chosen because the impact of the several PCA increases subject to deferral was heaviest in the early years of the deferral period. For example, from the base rate established in United's 2000 rate case ($0.026858 per Kwh) the Company experienced a 47.31% increase in schedule 9S energy cost (Company facilities of any size were virtually all subject to tariff 9S at this time) on May 16, 2001. The PCA for schedule 9S was adjusted again as of Oct 1, 2001 by an incremental increase of 9.67%. This brought the cumulative impact of PCA adjustments on Schedule 9S energy to over 62%. Again on May 16, 2002 the PCA was increased an additional incremental 4.91%, raising the cumulative impact to 69.5%. In May of 2003 some relief was received, but only in the form of a partial PCA decrease that still left energy rates 19.8% above the base rates established in the 2000 rate case. By December 2003, two-thirds of the balance of the current deferred asset had been incurred. Carrying charge interest rates have steadily decreased from the 2001 level of 6% to the current 1%.

Adjustment No. 13 increases operations and maintenance expense by $78,224 to reflect water treatment chemical usage and pricing over and above the test year level (Schedule 1, Page 13). Again, Witness Rhead supplied me the support for increased chemical expense for CWTP. This expense is estimated at $57,145. The Company has made a corresponding adjustment (No. 16) that reflects power and chemical savings at facilities that are anticipated to produce less water, initially, due to CWTP operations. The use of phosphate has been normalized upward from the test year level by $15,000. Company operating personnel have learned through experience that certain areas of the system become "unstable" in the winter season, leading to an increased level of customer complaints, unless phosphate use is continued through the winter season. The underlying adjustment for chemical expense utilized test year quantities of the various chemicals at the most current known prices. Due to price instability in the water treatment chemical market, the Company may need to update this adjustment as suppliers reveal 2005 prices.

Adjustment No. 14 increases test year expense by $7,662 (Schedule 1, Page 14) for the normalization and known and measurable changes to the Company's water quality outside laboratory expense. The Company follows a sampling regimen required by water quality regulators. In 2005, the "Long Term 2 Enhanced Surface Water Treatment Rule" takes effect, raising testing expense by $12,000. An expired amortization from the previous rate case was normalized out of the test year.

Adjustment No. 15 increases test year expense $57,210 for known and measurable operating expense items associated with the operation of CWTP (Schedule 1, Page 15). Major expense adjustments associated with Columbia are included in the individual adjustments to that particular expense, such as power, chemicals and purchased water. This adjustment includes communications expense (primarily, operation of a T1 line), outside laboratory cost and building utilities (natural gas, electricity, landscape and building maintenance, as well as sanitation and security alarm monitoring services).

Adjustment No. 16 (Schedule 1, Page 16) decreases the test year level of variable cost (power and chemicals) by $139,580 as a result of the operation of the CWTP. Witness Rhead, who supplied this estimate to me, has developed a plan of operations for Columbia that involves relying less on several groundwater sources. He has calculated a price per million gallons of operating the several facilities and this adjustment eliminates from expense the expected level of savings.

. Adjustment No. 17 increases the test year level of transportation cost by $43,652 (Schedule 1, Page 17). Transportation expense includes net lease cost, fuel cost, vehicle maintenance materials and outside service expense, payroll and overhead expense for the mechanic position and vehicle insurance. The primary drivers of the increasing expense are the addition of two new leased vehicles, increasing fuel prices and increased personnel wage and benefit cost.

Adjustment No. 18 increases test year expense by $8,061 for customer postage expense (Schedule 1, Page 18). The Company has included in this case an expected level of customers as of May 31, 2005 of 76,907, an increase of 1,507 customers from the test year-end level. The amount the Company's billing contractor charges to mail a customer bill is composed of several pre-sort postal rates, and averages $0.306. The Company also mails annually thousands (55,000+) of customer urgent notices through a postage machine resident in the local office, as well as all general office mail. A small amount of expense credits erroneously charged to UWID were normalized out of the test year.

Adjustment No. 19 (Schedule 1, Page 19) increases expense by $14,416 related to the Company's outside contractor who prepares customer bills. The number of bills to be processed was annualized on the same basis as customer postage. In addition to the per item price for bills and past due notices, the Company incurs a small amount of programming charges annually. Like customer postage, some out of period credits were normalized into test year expense, while the test year level of programming charges was normalized downward.

Adjustment No. 20 (Schedule 1, Page 20) reduces outside collection expense by $20,125. Outside collection includes bank service fees for collecting and processing customer payments, and miscellaneous other payments, be they made in person, through the mail or electronically. Again, the number of payments processed is based on the customer count at May 31, 2005. Test year expense was normalized resulting in an expense reduction.

Adjustment No. 21 (Schedule 1, Page 21) reduces expenses for customer records and collection expense and miscellaneous customer accounts expense by $10,879. For seven/twelfths of the test year the Company had a contract temporary "employee" provide services in this area for $14,466. This expense was eliminated when the position was filled with a regular employee whose expenses are included in the labor adjustment. However, the test year is missing the expense ($3,700) associated with printing United's annual notification to customers of rules & regulations, and this expense has been normalized. The remainder is a normal level for supplies and legal services.

Adjustment No. 22 decreases test year expense by $31,661 for the normalization of uncollectible accounts expense (Schedule 1, Page 22). The uncollectible accounts rate of 0.41565% was determined by dividing $498,727 of four-year total net uncollectible expense by four-year total revenues of $119,986,045. The resultant average uncollectible rate was applied to pro-forma revenue at existing rates.

Adjustment No. 23 increases test year expense by $3,476 for normalization of the annual IPUC assessment (Schedule 1, Page 23). The most recent Commission billing indicates an assessment rate of 0.002405%.This assessment rate is then applied to adjusted test year operating revenue to determine pro forma IPUC Assessment expense for rate purposes.

Adjustment No. 24 increases test year expense by $81,667 for rate case expense amortization (Schedule 1, Page 24). The Company estimates deferred expense for the instant case to be $245,000. This deferral is being tracked in detail and an updated cost projection will be available prior to hearings in the case. The Company proposes a three-year amortization period to coincide with the anticipated filing of the next general rate case.

Adjustment No. 25 increases test year expense of $25,688 by $1,477 for employee relocation expense amortization, traditionally a five-year amortization (Schedule 1, Page 25). The Company incurred additional relocation expense in early 2003 for the position of Senior

Technical Analyst, which was deferred. For rate making purposes the small balance of unamortized relocation expense that is leftover from the prior case is being re-amortized over five years.

Adjustment No. 26 increases test year expense for business insurance (casualty, property and workers compensation; Schedule 1, Page 26) from $789,765 to $1,083,300, an increase of $293,535. The test year level of expense was abnormally low due to a large, non-recurring property insurance credit of $109,271. Property Insurance coverage for the pro forma rate year is $55,500, a swing of nearly $165,000. The detail of the Company's business insurance package is illustrated on Schedule 1, Page 26.

Adjustment No. 27 eliminates $14,005 of expense recorded as lobbying, charitable contributions, and memberships, which are not appropriate for rate-making purposes based upon prior Commission decisions (Schedule 1, Page 27).

Adjustment No. 28 (Schedule 1, Page 28) increases the annual cost of supporting information technology (IT) infrastructure by $51,046 over the test year level. Operation and maintenance of the IT infrastructure is a shared responsibility between local personnel and corporate support. Corporate services include Infrastructure Operations such as helpdesk services, desktop/server engineering and support and network services including the local area network, wide area network, internet access (primarily for web-based programs) and remote access, as well as e-mail. It also includes Application Support for the customer billing system, PeopleSoft and operations system services. Vendor and contract management is also included. Local personnel maintain and support Oracle, maintain and support local file servers and databases, provide hydraulic model support and maintenance, oversee the Supervisory Control and Data Acquisition (SCADA) system including the Intellution software, provide local desktop support and support radio and telephonic communications systems. The primary drivers of expense increases are the level of finance system support and frame relay communications support.

Adjustment No. 29 (Schedule 1, Page 29) eliminates $2,995 of expense charged to account 930250, Enhanced Severance Package, during the test year that will not recur in the rate year.

Adjustment No. 30 (Schedule 1, Page 30) increases test year expense by $73,022 in recognition of the additional variable operation and maintenance expense that will be incurred as a result of the annualizing the impact of test year customer growth, as well as making a known and measurable change for customers to be added through May 31, 2005. The adjustment is based upon the relationship of test year levels of purchased power, chemicals, transportation, general insurance and T&D cost excluding payroll (the variable cost) to test year revenue. The variable cost represents 9.74% of revenue (line 11).

The 9.74% variable cost factor applied to customer growth revenue of $535,161 results in additional O&M expense of $73,022.

Adjustment No. 31 (Schedule 1, Page 31) decreases test year expense by $8,792 in recognition of lower operating cost associated with Witness Gradilone's weather normalization adjustment. The adjustment is based upon the relationship of purchased power and chemical cost (the variable cost) to test year revenue. The variable costs represent 4.93% of revenue (line 7). The 4.93% variable cost is applied to the weather normalization revenue impact of ($184,354) resulting in decreased O&M expense of $9,085.

Adjustment No. 32 (Schedule 1, Page 32) reduces test year outside legal expense by $29,094 related to the expiration of an amortization allowance granted in the prior case for deferred legal expense incurred to contest property tax valuations.

Adjustment No. 33 (Schedule 1, Page 33) increases test year expense by $1,569 due to a three-year amortization of deferred legal expense related to United's efforts to assist the Commission with the challenges posed by the Terra Grande Water Company.

Adjustment No. 34 (Schedule 1, Page 34) decreases test year expense by $986 due to the cessation of United's operation of the Carriage Hill non-contiguous system. The adjustment represents annual power expense. Depreciation expense and property taxes have selfadjusted. There were no chemicals used at Carriage Hill and the customer accounting expense is negligible.

Q. Please explain Exhibit No. 3, Schedule 2.

A. Exhibit No. 3, Schedule 2 consists of four pages. Page 1 summarizes the adjustment to depreciation expense in the amount of $1,647,661. Pro forma depreciation expense amounts to $6,386,509. This is $1,647,661 greater than depreciation recorded during the test year of $4,738,848 due to increases in the Company's plant investment. Plant investment information post July 31, 2004 was supplied to me by Witness Rhead.

Page 2 of Schedule 2 indicates the depreciable basis of Utility Plant by primary account, net of contributions and advances (advances for construction were judged as non-depreciable property until the Company had an investment in the property through the payment of advance refunds), the depreciation rate for each plant account and the annual depreciation expense by primary account. Pro forma annual depreciation expense is carried forward to Page 1 in order to determine the adjustment needed to test year expense. The depreciation rates used are the same as those utilized in prior rate case filings with one exception. The CWTP is a membrane filtration facility rather than a conventional treatment facility like the Marden WTP. The membrane filters themselves have a useful life that is not congruent with the 20-year life associated with other investment in water treatment equipment. Although membrane filter use in the public water supply field is an emerging technology, there is evidence that supports a seven- year life. First, USFilter, the manufacturer of the membranes, unconditionally warrants their membranes for one year and provides a lesser quality of warranty for the next six years. In addition, CDM Construction Inc., the Design-Build contractor for the CWTP provided, through Witness Rhead, two examples of operating membrane plants. The Saratoga Plant in the San Francisco Bay area replaced its membrane filters after seven years of use. The membrane filtration plant in Marquette, Michigan opened in 1997 and as of 2003 had not replaced the filters, though an attempt will be made by the Company to confirm whether replacement occurred in 2004. The Company is requesting permission to depreciate the membrane filters at a 14.00% annual rate, which is the best evidence of their expected useful life.

Q. Please explain Exhibit No. 3, Schedule 2, Page 3.

A. Exhibit No. 3, Schedule 2, Page 3 adjusts amortization of plant held for future use to $0 from a test year level of $51,113. This reflects the fact that investment in the raw water pumping station related to the CWTP will be used and useful coincident with the in-service date of the plant. The IPUC allowed United to recover a return of, but not a return on, the raw water pumping station and pipeline in prior rate case UWI-W-97-06. The instant adjustment re-categorizes the amortization of the investment held for future use to normal depreciation expense and has no impact on the overall revenue requirement. The accumulated balance of plant held for future use amortization is similarly reclassified to accumulated depreciation in a rate base adjustment

Q. Please explain Exhibit No. 3, Schedule 2, Page 4.

A. Exhibit No. 3, Schedule 2, Page 4 increases test year expense by $1,932 for the amortization of Utility Plant Acquisition Adjustments. The UPAA account has a gross balance of $600,762 as of July 31, 2004 and is comprised of acquisition adjustments previously approved by the IPUC in various cases, all with 20 to 40 year amortization periods. The small upward adjustment is caused by the normalization of an accounting error that occurred in the test year.

Q. Please explain Exhibit No. 3, Schedule 3, Page 1.

A. Exhibit No. 3, Schedule 3, Page 1 increases test year property taxes by $42,245. The schedule details the methodology used to arrive at a pro forma level of property tax expense. Essentially, historical property tax expense increases are averaged over a six-year period to derive an annual increase rate of 4.42%. This factor is applied to the estimated 2004 property tax expense of $1,504,445 to arrive at a pro forma level of expense, $1,570,941. This is an increase of $42,245 over the test year level of taxes, $1,528,696. The Company will have further insight into the level of tax expense with the arrival of the actual Ada and Canyon County tax bills later this year.

Q. Please explain Exhibit No. 3, Schedule 3, Pages 2, 3 and 4.

A. Exhibit No. 3, Schedule 3, Pages 2, 3 and 4 increase the test year level of payroll taxes by $30,277 combined. Page 2 indicates an increase in FICA taxes of $29,425. Page 3 shows an increase of $469 in Idaho State unemployment taxes. Page 4 reflects an increase of $383 in Federal unemployment taxes. The test year also included $227 in unidentified payroll tax that has been normalized out. The respective payroll tax increases are driven by salary increases and increased headcount. FICA has been adjusted based on information received indicating statutory limits and rates for 2005.

Q. Please explain Exhibit No. 3, Schedule 4.

A. Exhibit No. 3, Schedule 4, Page 1 of 1 shows the calculation of state and federal income taxes at existing and proposed rates. The amounts shown on line 1 of columns 1 and 2 are the same as the amounts shown on line 16 of columns 4 and 6 of the summary schedule of Exhibit No. 2. These figures represent operating income before income taxes. From these figures must be deducted the applicable statutory deductions when computing the state and federal income taxes.

The first deduction is imputed interest expense and it is deductible in the computation of both state and federal taxable income. The calculation for the interest deduction is shown in Note A on lines 13 through 17. The deduction of interest is shown on line 3 and is self-explanatory.

The second deduction is the excess of pro forma tax depreciation over pro forma book depreciation. The excess tax depreciation is deducted from state taxable income only since state income taxes are calculated on the basis of flow through accounting while federal income taxes are calculated on the basis of normalization accounting. Lines 19, 20 and 21 indicate the amounts used in determining excess tax depreciation.

The remaining calculations are self-explanatory except for the amortization of investment tax credit shown on Line 10. Federal income tax expense was reduced by the amortization of ITC that is amortized ratably over the lives of the assets and represents 2% of the ITC claimed from 1971 through 1999.

Q. Please explain the adjustment shown on line 6, Column 5 of Exhibit No. 2.

A. The adjustment shown on line 6, Column 5 of Exhibit No. 2 represents additional uncollectible expense and IPUC assessment as a result of the pro forma adjustment to operating revenue shown on line 4, Column 5 of Exhibit No. 2.

Q. Does this conclude your testimony regarding operating expenses?

A. Yes.

Q. Please address your rate base testimony.

A. Rate base is founded on an actual test year ended July 31, 2004. Also, known and measurable adjustments are made to rate base components through May 31, 2005, incorporating adjustments that will take place prior to the time that rates will become effective in this proceeding.

Q. What is the level of rate base the Company is requesting in this proceeding?

A. The rate base is $140,062,546. This includes an increase in gross plant investment of $31,156,521 (net of retirements) that will go into service prior to the rates effective date in this case. Included in this gross capital is $2,555,658 associated with the raw water pumping station, which will serve the CWTP. This asset has been resident in plant held for future use since 1997 but will become used and useful with the commencement of operations of CWTP. Rate base as determined in the 2000 case was $98,862,937.

Q. Please explain Exhibit 1, Page 1 of 9.

A. Exhibit 1, Page 1 of 9, Rate Base Summary, indicates the elements of the Company's rate base as of July 31, 2004, as reflected on the financial statements of the Company. The elements are Utility Plant in Service; Accumulated Depreciation, Accumulated Amortization of UPAA and Accumulated Amortization of Plant Held for Future Use; Customer Advances for Construction; Contributions In Aid of Construction; Utility Plant Acquisition Adjustments; Accumulated Deferred Income Taxes; Pre-1971 Investment Tax Credits; Deferred Charges and Working Capital. It is necessary to adjust the "per book" amounts due to reclassifications and adjustments. These adjustments, if any, are shown in Column (B). As you will note, there are no adjustments in Column B. The working capital allowance, on line 10, was calculated in accord with past Commission practice and as such, does not require a separate adjustment page. The adjustments in Column D reflect pro forma adjustments to Plant in Service, Accumulated Depreciation and Amortization, Advances for Construction, Contributions in Aid of Construction, Accumulated Deferred Income Taxes, Pre-1971 Investment Tax Credits and Deferred Charges.

Q. Do you have an Exhibit regarding plant in service additions?

A. Yes. I have Exhibit 1, Page 2 of 9. Total plant in service as of approximately May 31, 2005 is expected to be $258,639,920. Witness Rhead has summary and detailed testimony and exhibits regarding pro forma additions and retirements to plant in service. I have incorporated these exhibits into rate base.

Q. How do your rate base exhibits treat the Carriage Hill disposal recently decided before the IPUC?

A. Original booking entries for Carriage Hills, and subsequent activity has been "undone" in these exhibits. Plant in service, accumulated depreciation, advances and contributions have all been adjusted to erase the vestiges of Carriage Hill.

Q. Please explain Exhibit 1, Page 3 of 9.

A. Exhibit 1, Page 3 of 9 explains changes in the balance of accumulated depreciation, accumulated CIAC amortization, accumulated amortization of PHFU and accumulated amortization of UPAA for the period July 31, 2004 through May 31, 2005. The major additions represent ten months of depreciation expense (including projects placed in service between August 1, 2004 and May 31, 2005) and CIAC amortization. The primary deduction is pro-forma plant in service retirements along with associated cost of removal or salvage. The balance of accumulated amortization of plant held for future use is simply transferred from its home account into the accumulated depreciation account, to mirror the treatment of the asset. UPAA debits and credits are all amortized over twenty or forty year periods, as approved by the Commission in various decisions.

Q Please explain Exhibit 1, Page 4 of 9.

A. Exhibit 1, Page 4 of 9 summarizes pro forma changes to advances for construction. It was necessary to reclassify some advance plant account designations as of the end of the test year to correct misstatements in the asset management system. Since the issuance of Order No. 28505 in case UWI-W-00-1, the Company does not depreciate advanced property. This requires the Company to accurately track, by associated plant account, all additions and refunds impacting the advance account. On a pro forma basis, the Company has adjusted the balance of Advances downward by $376,073 for refund activity that will occur from July 31, 2004 to May 31, 2005 on existing contracts. Also, the sale of the Carriage Hill non-contiguous property has been reflected by "un-doing" the original booking entries, reducing advances an additional $330,906. The Company does not foresee any additions to advances in the pro forma period. Additions, in the last 5 years, have typically occurred due to special facility agreements or non-contiguous development agreements. The new business and engineering group are unaware of any prospective activity in these respective areas.

Q. Please explain Exhibit 1, Page 5 of 9.

A. Exhibit 1, Page 5 of 9 indicates activity in Contributions in Aid of Construction that is all related to CIAC on the books as of July 31, 2004. Some of these CIAC dollars, $544,626, are associated with CWIP. The CWIP is not included in this case as of July 31, 2004 or in the pro forma period, and therefore associated CIAC has been removed. Also, the CIAC balance has been reduced by ten months of amortization, $954,170. No new investment funded by CIAC has been included in rate base from the test year-end. The vast majority of new customers are associated with developer funded mains and services. Since assets acquired in this manner have no impact on Company investment, they are not reflected in rate base. However, new customers added in the pro forma period contribute revenue, as discussed by Witness Gradilone. These customers also impact operating and maintenance expense as noted in many of the expense adjustments. CIAC associated with Carriage Hill has again been removed.

Q. Please explain Exhibit 9, Page 6 of 9.

A. Exhibit 9, Page 6 of 9 indicates pro forma adjustments to Utility Plant Acquisition Adjustments on a gross basis. The UPAA gross balance is comprised of both debit and credit balances. The gross value of the six individual adjustments, all approved by the Commission in various proceedings, is a positive $600,762. Amortization of these Acquisition Adjustments was previously reflected on Exhibit 1, Page 3 of 9.

Q. Please explain Exhibit 1, Page 7 of 9.

A. Exhibit 1, Page 7 of 9 indicates the changes to accumulated deferred income taxes from July 31, 2004 to May 31, 2005. The tax depreciation portion of this account was adjusted through May 31, 2005 for assets in service as of July 31, 2004 as well as assets added in the pro forma period.

Q. Please explain Exhibit 1, Page 8 of 9.

A. Exhibit 1, Page 8 of 9, represents the pro forma calculation of pre-1971 investment tax credits that are deducted from rate base and amortized at a rate of $750 annually. The balance at July 31, 2004 was $16,620. This is adjusted by $625 to reflect the balance at May 31, 2005.

Q. Please explain Exhibit 1, Page 9 of 9.

A. Exhibit 1, Page 9 of 9, identifies the six deferred items the Company has included in rate base. The most significant item is obviously the deferred power on line 2, encompassing over 76% of the entire balance of $2,031,692. Again, this power expense was deferred in accord with Commission Order No. 28800 in Case No. UWI-W-01-2. The Company deserves an opportunity to earn a fair return on this investment while it is being amortized to expense.

Q. Does this conclude your testimony with regard to United Water Idaho's rate base?

A. Yes.