RECEIVED ☒
FILED ☐
2005 APR -6 PM 4:51
IDAHO PUBLIC
UTILITIES COMMISSION

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-04-4

DIRECT TESTIMONY OF DONN ENGLISH

IDAHO PUBLIC UTILITIES COMMISSION

APRIL 6, 2005

Q. Please state your name and business address for the record.

A. My name is Donn English. My business address is 472 W. Washington, Boise, Idaho 83702.

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

A. I am employed by the Idaho Public Utilities Commission (Commission) as an auditor in the accounting section.

Q. What is your educational and experience background?

A. I graduated from Boise State University in 1998 with a BBA degree in Accounting. Following my graduation I accepted a position as a Trust Accountant with a pension administration, actuarial and consulting firm in Boise. As a Trust Accountant, my primary duties were to audit the day-to-day financial transactions of numerous qualified retirement plans. In 1999 I was promoted to Pension Administrator. As a Pension Administrator, my responsibilities included calculating pension and profit sharing contributions, performing required non-discrimination testing and filing the annual returns (Form 5500 and attachments). In May of 2001, I became a designated member of the American Society of Pension Actuaries (ASPA). I was the first person in Idaho to receive the Qualified 401(k) Administrator certification and

I am one of approximately ten people in Idaho with the Qualified Pension Administrator certification. In 2001 I was promoted to a Pension Consultant, a position I held until 2003 when I joined the Commission Staff.

With the American Society of Pension Actuaries, I served on the Education and Examination Committee for two years. On this committee I was responsible for writing and reviewing exam questions and study materials for the PA-1 and PA-2 exams (Introduction to Pension Administration Courses), DC-1, DC-2 and DC-3 exams (Administrative Issues of Defined Contribution Plans - Basic Concepts, Compliance Concepts and Advanced Concepts) and the DB exam (Administrative Issues of Defined Benefit Plans). I have also regularly attended conferences and training seminars throughout the country on numerous pension issues.

Q. Have you previously testified before this Commission?

A. Yes, most recently in cases AVU-E-04-1 and AVU-G-04-1. I have also provided testimony in Idaho Power Company's most recent rate case, IPC-E-03-13.

Q. What is the purpose of your testimony in this proceeding?

A. The purpose of my testimony is to present Staff's findings and recommendations regarding United Water Idaho's (United Water; Company) operating expenses.

Q. Are you sponsoring any exhibits with your testimony?

A. Yes, I am sponsoring Exhibit No. 108 consisting of 34 schedules and one summary page, and Exhibit No. 109 consisting of three schedules.

Q. Would you please explain Exhibit No. 108?

A. Exhibit No. 108 details all of the adjustments made by Staff to the Company's operating and maintenance expense, and compares those adjustments to what United Water filed in their Application. The first page of Exhibit No. 108 is a summary of the adjustments to operating expenses that United Water included in its original filing. The summary lists the pro forma amounts calculated by the Company to be included in rates and compares them to the amounts that Staff believes to be appropriate. The last column (Column 8) is the difference between the Company's proposed expense adjustments and Staff's proposed expense adjustments. The summation of Column 8 ($1,948,159) is the total amount that Staff has removed from operating expenses, excluding payroll taxes and depreciation expense, included in the Company's filing.

Each schedule of Exhibit No. 108 coincides with the page numbers of Exhibit No. 3, Schedule 1 sponsored by Company witness Healy. In these schedules, I have started with the amount that the Company proposes to include in rates and then illustrate the calculation used to determine Staff's adjustment.

Q. Please explain Schedule No. 1 of Exhibit No. 108.

A. Schedule No. 1 reflects the adjustment for payroll costs chargeable to operation and maintenance expenses. It starts with the calculation of the amount that the Company requested for recovery in rates, which is similar to Exhibit No. 3, Schedule 1, page 1 of 34 of Mr. Healy's direct testimony. After the illustration of the Company's request, Staff's adjustments are factored in to determine the amount that should ultimately be allowed for recovery by the Company.

Q. Please briefly explain how the Company calculated its adjustment.

A. As indicated on page 7 of Mr. Healy's direct testimony, United Water has proposed an adjustment to test year payroll to account for known and measurable increases to employee wages. The Company employs Bargaining Unit (Union) employees, and the union contract calls for wage increases to take effect on April 1, 2005. For non-Bargaining Unit employees, the Company estimated a 3.6% increase in salary.

The Company also proposes to recover wages paid for three new full-time positions. Two of the new positions are operations positions related to the Company's increased source of supply, pumping, and treatment facilities (Healy, Di, pg 7). The third position is a Public Relations Manager, which the Company states 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" (Healy, Di, pg 8).

As of the filing of this testimony, it is Staff's understanding that only the two operations positions have been filled. The Company is currently seeking to fill the position of Public Relations Manager.

Q. Please explain Staff's adjustments to the Company's pro forma payroll.

A. The first adjustment, reflected on line 17, removes $133,462 from the Company's pro forma payroll for the Short Term Incentive Plan (STIP).

Q. Please describe the Company's Short Term Incentive Plan.

A. Information provided to Staff as a part of the Company's response to Audit Request No. 21 explains the purpose of the incentive plan. Following is an excerpt from that response:

> The Short Term Incentive Plan (STIP) is an annual compensation plan that supports United Water's business objectives by:
>
> - Providing an annual incentive strategy that drives performance towards

objectives critical to creating shareholder value.
- Offering competitive cash compensation opportunities to all eligible employees.
- Awarding outstanding achievement among employees who can directly impact United Water's results.
- Providing cash awards for both qualitative and quantitative results.
- Providing cash compensation opportunities for making sound business decisions that impact the Company's financial performance and the overall success of Suez.

Q. Why does Staff object to the inclusion of incentive payments in customer rates?

A. Staff objects to the inclusion of the Short Term Incentive Plan in customer rates for the following five reasons:

1. United Water Idaho sufficiently compensates its employees with a generous base salary and additional benefits, such as pension plan benefits, matching contributions on 401(k) contributions, medical, dental, vision and life insurance, paid vacation time and holidays.

2. Short Term Incentive Plan payments fluctuate from year to year and may not be paid at all if the objectives are not met. It is impossible to predict that the Company will meet its financial goals and employees will meet their individual objectives in the future, therefore the incentive payments are neither known nor measurable.

3. The objectives of the STIP are financial objectives for creating shareholder value and the overall success of Suez Lyonaise, United Water Resources' parent Company. By aligning the incentive payments to the financial performance of a parent Company, there is no benefit to United Water Idaho customers when those objectives are met and payments are made.

4. The STIP rewards employees for merely doing a job that they are already being compensated for. Further information provided as a part of the Company's response to Staff's Audit Request No. 21 indicates that employees may receive an incentive payment if only 80.1% of the financial objectives are achieved. Staff believes that an incentive payment that kicks in as soon as 80% of financial objectives are achieved is extremely lenient and the costs of such payments should not be passed on to customers.

5. Incentive plans are self-funding. The incentive plan only makes sense if the savings achieved are greater than the amount of incentive payments made. Any additional savings would self-fund the incentive plan.

Q. Why do you believe United Water employees are paid a generous base salary?

A. According to the Department of Labor's Bureau of Labor Statistics Wage and Compensation Survey released in August of 2004, the average wage for working Americans is

$17.75 per hour. The average wage received by workers in the Mountain Census Division is $16.63 per hour. United Water Idaho employees received an average base wage of $23.25 per hour in 2003 before any benefits were included. Furthermore, the statistics indicate that the average hourly wage for meter readers in this country is $15.58 per hour. The average wage of the four meter readers employed by United Water is $16.68 per hour.

Q. Has the Commission excluded incentive payment plans in the past?

A. Yes, most recently in Order No. 29505 regarding Idaho Power Company's Application to increase rates in Case No. IPC-E-03-13. In addition to the five arguments listed above, the Commission expressed concern about public perception with a utility company offering bonuses to employees at ratepayer expense during a time of increasing rates.

Q. Please continue with your explanation of Schedule No. 1.

A. Line 18 of Schedule 1 removes from the pro forma payroll $6,000 in Above and Beyond the Call of Duty (ABCD) Awards. The Company uses ABCD Awards to reward employees for accomplishments or ideas that improve the Company's overall productivity or efficiency. While Staff appreciates the Company's willingness to reward employees for going above and beyond the call of duty, we have removed the $6,000 from pro forma payroll for three main reasons.

First, the Company has not been using the ABCD Awards program recently and did not reward any employees during 2004. In fact, the Company only rewarded employees a total of $500 in each of the two years prior to 2004. The $6,000 included in pro forma payroll is only an estimated budgeted amount, and payment of any ABCD Award is not known to occur, nor can it be measured in advance.

Secondly, as discussed previously, employees of the Company are well paid. One of the responsibilities of being a well-paid employee is commitment and loyalty to your employer. Along with that loyalty comes the responsibility to perform your best at all times, and to look for ways to improve efficiency and productivity. Employees who display those characteristics will eventually be rewarded with annual merit-based raises in salary. ABCD Awards allow for the possibility for employees to be rewarded for simply doing what they are expected to do on a regular basis.

And finally, if employees' actions or suggestions actually improve the productivity or efficiency of the Company, then the reward program would be self-funding. The savings achieved by the Company from implementation of the employee's suggestion should outweigh the cost of the reward; otherwise the reward would not be prudent.

Q. Are there any other adjustments to the Company's payroll?

A. Yes, line 19 of Schedule No. 1 removes amounts in excess of the 3.3% wage increase that was granted to non-union employees. At the time of filing its Application to increase rates, the Company had used an estimated wage increase of 3.6% for non-union employees. United Water Idaho just recently learned that its parent Company has approved a 3.3% increase for its non-union employees. Staff has removed from pro forma payroll $10,525 to reflect this decision to approve a lower payroll increase.

However, when calculating the proposed wage increase, the Company included several vacant positions that had not been filled. Staff believes it is not appropriate to let the Company recover in rates the wage increases that would be allocated to unfilled positions or new employees who have not yet completed a probationary period. Therefore, the $10,525 that Staff has removed from pro forma payroll includes removal of salary increases for new employees and vacant positions.

Line 20 removes from pro forma payroll the dollar amounts for budgeted overtime pay in excess of 2004 actual overtime pay. The Company estimates overtime pay at $103,374. The Company's response to Staff's Production

Request No. 182 indicates that 2004 actual overtime pay was only $99,136. Staff objects to the use of estimated overtime pay because it is not known and measurable. Therefore, $4,238 has been removed from the Company's pro forma payroll to reflect overtime pay at actual 2004 levels.

Line 21 removes from pro forma payroll the amount of projected wages included in the Company's filing for the Chief Operator position above the actual wage currently being paid. At the time of filing its Application, the Company projected the wage for the new position of Chief Operator to be $23.28 per hour or $48,422 per year based on 2,080 working hours. The Company's response to Staff's Production Request No. 164 indicates that the position has since been filled, and as of December 31, 2004 the current wage being paid for that position was $21.86 per hour or $45,468 per year. Line 21 reflects the removal of the additional $2,954 included in the Company's request.

Line 22 removes from the Company's pro forma payroll the $56,000 projected salary for the new, proposed position of Public Relations Manager. As of the time of filing of this testimony, the position of Public Relations Manager is still vacant. Staff believes it is neither known with certainty that this position is going to be filled, nor the exact salary that will be paid to the individual, if any, that is hired to fill this position. Furthermore, Staff believes the duties of this position would include that associated with corporate image and lobbying.

Company witness Healy states on page 8 of his direct testimony:

> 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 communication, community involvement, legislative issues, media relations and others.

The job postings in the Idaho Statesman and Idaho Press Tribune indicate that the Company is seeking an applicant that has a "keen understanding of local governmental affairs; and be skilled in political networking." The successful candidate must also have a bachelor's degree in Communications, Public Relations, Marketing or Advertising.

This Commission has a long-standing precedent of excluding lobbying expenses from customers' rates. The duties described in the job postings and in Mr. Healy's testimony indicate that a major portion of this position's responsibility will be lobbying. Though this position may have additional responsibilities, those responsibilities would not pertain to the production, transmission and distribution of water, and thus the salary of this position should not be included in customer rates.

Q. Does that conclude Staff's adjustments to the Company's pro forma payroll chargeable to operations and maintenance?

A. Yes, although it is important to note that a portion of all incentive payments is capitalized. In order to remove all the effects of the incentive payment plan, an adjustment of $135,630 to rate base, as well as an adjustment of $4,361 to annual depreciation expense are required to completely remove the costs associated with the Short Term Incentive Plan. These amounts have been provided to Staff witness Harms to incorporate into her testimony regarding depreciation and rate base.

Q. Would you please explain Schedule No. 2 of Exhibit No. 108?

A. Schedule No. 2 reflects Staff's adjustment to the Company's proposal to increase the amount of 401(k) matching contributions above the test year level. The Company proposes an adjustment to test year expenses for 401(k) matching contributions by using a weighted average contribution percentage for all employees (2.1892%) and then multiplying that percentage by pro forma eligible payroll ($4,178,650.83).

Q. Why does Staff object to the Company's adjustment?

A. Staff objects to this adjustment simply because the amount of 401(k) matching contributions is neither known nor measurable. The Company simply took an estimated amount (contribution percentage) and multiplied it by another estimated amount (pro forma payroll) and claims the result is known and measurable.

The United Water Resources, Inc. 401(k) Plan (401(k) Plan) allows employees to cease their salary deferrals at any time, thus ending the responsibility of the Company to contribute a matching contribution. Furthermore, the 401(k) Plan allows all eligible employees who are not currently contributing to commence payroll deductions for the 401(k) at any time. With the numerous vacant positions and employee turnover, it is not possible to determine a precise amount for the Company's 401(k) Matching Contribution expense. Therefore, Staff rejects the Company's adjustment and removes the $1,321 from the Company's filing.

Q. Please explain Schedule No. 3 of Exhibit No. 108?

A. Schedule No. 3 illustrates the calculation of the Company's adjustment to Employee Health Care Expense, Long Term Disability and Group Term Life Insurance Expense. The adjustment filed in the Company's Application was calculated based on the July 2004 authorized level of employees (Healy Di, pg 9). However, Mr. Healy indicates later in his testimony that the open enrollment period in the late fall of 2004 would affect the Company's cost of providing these benefits and the adjustment may need to be revised. Staff has reviewed the Company's revised Employee Insurance estimates as of December 31, 2004 and finds them to be reasonable. Staff's acceptance of the Company's revised numbers increases the pro forma Employee Insurance Costs filed in the Company's Application by $21,923.

Q. Please explain Schedule No. 4 of Exhibit No. 108?

A. Schedule No. 4 illustrates Staff's adjustment to pension expense.

Q. Please describe the pension plan and the Company's treatment of pension expense.

A. United Water Resources, Inc. sponsors two traditional pension plans in which participants will receive a set monthly income upon retirement that is based on their years of service and their final average earnings. One plan is for the Bargaining Unit employees and the other is for non-Bargaining Unit employees. These plans are fully funded by United Water Resources, Inc. and its affiliates. Assets in the plans are secured in a trust and guaranteed by the Pension Benefits Guarantee Corporation.

United Water Resources, Inc. obtains the services of an actuary to calculate pension expense. The actuary calculated pension expense on a business unit basis, so United Water Idaho's pension expense is separately calculated and not allocated from the corporate level.

United Water Idaho is proposing to use the expense calculated under the methodology provided by Statement of Financial Account Standards No. 87 (FAS 87) for both of the pension plans.

Q. Please describe FAS 87 expense.

A. FAS 87 expense, also referred to as Net Periodic Pension Cost (NPPC), is a reference to the statement issued by the Financial Accounting Standards Board (FASB). The statement was issued to alleviate long-standing controversy regarding how to report for pension liability. It mandates the use of Net Periodic Pension Cost for reporting pension expense on a Company's financial statements. The NPPC is an accrual of pension expense for a given year, but it is not the actual amount of cash that a Company is required to contribute to a pension plan to meet its minimum funding liability and avoid interest and penalties. It is also important to note that FAS 87 makes no mention of regulatory accounting.

Q. Have there been any perceived problems with FAS 87?

A. Yes. There has been a growing concern among accounting professionals regarding the use of FAS 87 and the potential for manipulation of financial statements. In 2003, the FASB agreed to put further review of FAS 87 on its formal agenda. Though the Board has not made any changes to the Statement, the concern is still present.

Q. What was the actual amount of cash contributed to the pension plans (United Water Resources) during 2004?

A. The Employee Retirement Income Security Act (ERISA) and Section 412 of the Internal Revenue Code mandate the required minimum contribution necessary for a plan sponsor to meet its funding obligations. A completely different calculation is used to determine the minimum cost for a given plan year. The ERISA funding requirements for United Water Resources, Inc. are determined on a plan basis and not on a specific business unit basis. In years where the minimum required contribution is greater than zero, the minimum is then allocated over the participating companies in the plan. In years where the minimum contribution is zero and no contribution is made, there is no allocation needed or performed.

For the non-Bargaining Unit plan, no contributions were required or made to the plan for the five years covering 2000 through 2004. Staff initially tried to obtain further historical information to determine ten-year trends, but agreed to accept five years' worth of information after the Company indicated the reports were too voluminous and would be burdensome to photocopy.

For the Bargaining Unit plan, there were no contributions made in 2000-2002. The actuarial calculations of the actual cash contributions were not provided to Staff, however the information was available on the Form 5500, the Annual Return/Report of Employee Benefit Plans that is required to be filed annually pursuant to Sections 104 and 4065 of ERISA and Section 6047(e), 6057(b), and 6058(a) of the Internal Revenue Code. The 2003 Form 5500 for the Bargaining Unit plan indicated that the total cash contribution required and made to the plan for 2003 was $706,187. This amount represents the total contribution of all business units to the United Waterworks, Inc. Employees Retirement Plan - Bargaining Unit. Staff estimates that Idaho's portion of the 2003 contribution was approximately $162,454. This amount was calculated by taking Idaho's actuarially calculated FAS 87 expense and dividing it by the overall total of actuarially calculated FAS 87 expenses for all business units with positive FAS 87 expenses. The resulting percentage was then multiplied by the cash contribution to estimate Idaho's share. All business units with negative FAS 87 expenses were excluded from this allocation process because it would be impossible for a Company to make a negative cash contribution to the plan. Staff admits that our calculation of Idaho's portion of the cash contribution may not be exact, but it does obtain a just and reasonable result that should be very similar to the allocation that may have been calculated by United Water Resources, Inc.

The 2004 cash contribution to the Bargaining Unit plan was not provided to Staff, and the 2004 Form 5500 is not required to be completed and filed until October 15, 2005. Therefore, Staff could not ascertain the exact amount of cash contributions due to the plan for 2004.

Q. Please briefly describe ERISA.

A. ERISA was enacted by Congress in 1974 to ensure some level of security in employee benefit plans. Since its enactment, pension plans are subject to intense federal regulation because of the long-term nature of the benefit obligation and the resulting potential for changed circumstances. One of many ERISA requirements is the systematic advanced funding requirements to protect employees against employer default. ERISA mandates the minimum amount that must be funded each year to a pension plan to avoid a funding deficiency.

Q. How is this amount calculated?

A. The first step of the calculation is to determine the Normal Cost for the year. The Normal Cost is the annual cost of the plan using the plan's actuarial cost method as established in the plan document. The Normal Cost is a calculation that takes into consideration the present value of future benefits, the actuarial value of the Plan's assets, any unfunded liabilities and the present value of the Company's future payroll. This information is used to calculate an accrual rate that is then multiplied by the Company's current payroll to produce the Normal Cost. By adding or subtracting any charges or credits to the Normal Cost one can obtain the Annual Cost. The Minimum Required Contribution is the lesser of the Annual Cost or the difference between the Full Funding Limitation and any credit balance. This minimum contribution is the amount that a Company must fund in order to avoid a funding deficiency in the Funding Standards Account.

Q. Are you suggesting that this Commission adopt a policy that only the ERISA required minimum contribution be accepted for rate recovery?

A. I am not necessarily recommending a strict policy of only accepting the ERISA required minimum amount for rate recovery purposes, but I do believe that the ERISA minimum contribution is the best starting point in determining the amount to allow for recovery. When dealing with the different pension calculations, it is important to remember that these "costs" we are referring to are artificial numbers that have no connection to real-world values. These costs do not accurately estimate the value of the plan's liability to pay benefits, the Company's legal liability should the plan be terminated, or the value of benefits accumulated under the plan. These calculations are simply a means by which the federal Tax Code and the ERISA regulations dictate the level of funding in a plan for purposes of tax deductions and minimum funding rules. The calculation methodologies consist of using inaccurate data and speculative assumptions and running them through an overly precise formula to produce a cost calculation. Therefore, there is no accurate contribution value, and we are forced to rely on a number that is produced by the calculations. Given the speculative nature of pension contribution calculation, I believe it is wise for the Commission to reserve some discretion in determining amounts to be recovered through rates based on the individual facts and circumstances of each case. Given the large requested rate increase in this case, funding at the ERISA minimum level is appropriate.

Q. Are there any other differences between FAS 87 expense and the calculations performed under ERISA that you would like to address with the Commission.

A. The cash contribution (ERISA) and the pension expense (FAS 87) calculations both reflect the cost of a pension plan - one as cash and the other as a reduction in Company earnings. Both are calculated using similar principles, but the rules for calculation are very different. Some specific differences that have not already been previously mentioned are:

1. FAS 87 allows the projection of benefit limits under IRC 415, compensation limits under IRC 401(a)(17) and other items that are not used in the ERISA calculations.
2. FAS 87 explicitly counts assets based on the actual time separated from the employer's control, while ERISA calculations have provisions for receivables.
3. Asset smoothing is not used in FAS calculations as it is in ERISA calculations.
4. FAS 87 has a specific funding method (pro-rata unit credit), and a unique amortization of past service liabilities that do match the funding rules under ERISA.

There are many other differences between FAS 87 expense and the ERISA contributions, but those are a few of the major points.

Q. What amount are you recommending the Company be allowed to recover in rates for pension expense?

A. I believe the Company should recover the actual amounts of cash contributions it would have been required to contribute to the plan for 2004. For the non-Bargaining

Unit plan, this amount is $0.00. The Bargaining Unit contribution for 2004 was not provided to Staff, and Staff had to rely on the 2003 report and calculations as mentioned earlier. Therefore, Staff accepts the amount of $162,454, which is approximately Idaho's portion of the overall contribution.

Q. Would Staff allow United Water Idaho to recover their portion of the overall Bargaining Unit pension contribution for 2004 if the Company provided those calculations?

A. Yes. I have reviewed the actuarial assumptions used in determination of the contributions and expense and believe them to be reasonable and in line with what the Commission has approved for other utilities in recent cases. Provided that the actuarial assumptions did not change from 2003 to 2004, I believe the acceptance of Idaho's portion of the ERISA minimum required cash contribution is appropriate.

Q. Has anything led you to believe that these amounts will increase dramatically in the near future?

A. The most compelling driver of pension cost is market performance. Though future market performance is uncertain, the Company's hired actuaries state in its report their prospective view of the pension plans:

> Going forward, we see evidence of recovery with actual yields well in excess of expected yields. This, however, includes

the moderate to flat performance during 2004 prior to the presidential election. The measurement date of 9/30/04 reflects assets prior to the election results. As a measure of conservatism, we recommend continuing with an 8.5% per annum as planned. We will revisit the rate for a potential increase, if experience continues to support a higher long-term yield.

Given the Company's actuary's comments and the potential for an increase in the expected long-term yield on assets assumption, I don't believe the contributions to the plan will increase dramatically in the near future. Though it is important to note that pension contributions do fluctuate and can vary widely from year to year.

Q. Please explain Schedule No. 5 of Exhibit No. 108?

A. Schedule No. 5 is similar to Mr. Healy's Exhibit No. 3, Schedule 1, page 5 of 34. The Company reduces the test year Post Retirement Costs by $145,345 to reflect the 2005 Post Retirement Costs calculated by the Company's actuary in accordance with Statement of Financial Accounting Standards No. 106 (FAS 106). Staff has reviewed the calculations and the provisions of FAS 106 and accepts the Company's adjustment.

Q. Please explain Schedule No. 6 of Exhibit No. 108?

A. Schedule No. 6 illustrates the adjustments to payroll overheads charged to construction and other non O&M

accounts. This schedule uses the same calculation method that the Company uses in Mr. Healy's Exhibit No. 3, Schedule 1, page 6 of 34, however many of the amounts listed on Schedule 6 tie to amounts listed on other schedules and adjustments. Staff witness Stockton has reviewed the calculation method and has deemed it to be reasonable. This schedule simply updates the Company's figures to incorporate Staff's adjustments to payroll and benefits, including payroll taxes. The effect of Staff's adjustment increases the payroll overhead chargeable to construction and other non O&M accounts proposed by the Company by $12,478.

Q. Would you please explain Schedule No. 7 of Exhibit No. 108?

A. Schedule No. 7 illustrates the calculation of Staff's adjustment to the amortization of deferred costs associated with the early retirement program.

Q. Why does Staff object to the deferral of the early retirement program costs?

A. Staff objects to the recovery of the costs associated with the early retirement program for two main reasons. First, the Company has not proven that the benefits exceed the costs at the Idaho level. Secondly, the Company did not follow established regulatory procedures, nor did it follow its own internal procedures when deferring these costs.

Staff inquired of the Company to provide the cost/benefit analysis of the early retirement program and enhanced severance packages in Production Request No. 180. The Company's response indicated that the cost/benefits analysis was prepared by its actuary and were "performed on a total pension plan basis and are not specific to any individual Company." The study clearly indicates that on a corporate-wide level, United Waterworks achieved significant savings from the early retirement plan. However, at the United Water Idaho level, the savings were not so clear. Idaho water users and ratepayers do not benefit when the Company's parent achieves savings, and therefore should not be required to pay costs associated with the increased earnings of the parent company. The study did not illustrate any cost savings associated with the enhanced severance packages.

Q. How did Staff substantiate the savings, if any, experienced by United Water Idaho from the early retirement plan?

A. A review of Mr. Healy's workpapers in this current proceeding indicates that in 2000, only six employees took advantage of the early retirement opportunity. Those six individuals had a combined salary of $252,527. The Company is seeking to recover $1,288,669 worth of expenses amortized over 60 months, or $257,734 per year, which is more than the combined salaries of those six employees. Furthermore, the salary savings alone in the almost 5 years since those employees retired would have funded the Company's allocated expense of the early retirement plan, and by allowing the Company to collect those expenses from customers, the Company would in essence be recovering these costs at least twice.

Q. You mentioned the Company did not follow procedures when deferring these costs. Would you please elaborate?

A. Yes, the Commission has ruled in the past that the deferral of significant expenses must be approved before those expenses can be recovered in rates. Specifically, in Order No. 25880, page 9, relating to Idaho Power Company's request to recover nearly $7 million in environmental costs associated with the Pacific Hide clean-up, the Commission stated:

> The alternative the Company proposed to recover the $7 million costs of the clean-up, recouping the amount through rates over the next five years, would violate the principle that rates must be prospective and may not be used to recoup past losses. The proscription against retroactive ratemaking means the Pacific Hide amounts spent by IPCo in the past are not recoverable through future rates unless they were preserved for that purpose by deferral or other regulatory action. When it became aware the clean-up costs would be substantial, the Company had the opportunity to request rate relief or deferral of these

> costs for future recovery. It did neither. Had the Company requested deferral of these costs **and the Commission had approved it**, we could now amortize this expenditure. However, that is not the case and we are without a means to provide recovery of this expense retroactively. [emphasis added]

The Commission affirmed its position in Order No. 28097, page 11, regarding Avista Corporation's request to recover in rates a portion of the damages incurred from the 1996 ice storm. The Commission in that order stated:

> In this regard we find the transcript reference to our treatment of Idaho Power's Pacific Hide hazardous waste clean-up costs to be on point. Tr.p.682-683; reference Idaho Power Order No. 25880. Avista's proposal to recover uninsured costs of 1996 ice storm damages through rates would violate the principle that rates must be prospective and may not be used to recoup past losses. The proscription against retroactive ratemaking means ice storm costs expended by the Company in the past are not recoverable through future rates unless they are preserved for that purpose by deferral or other regulatory action. When it became aware that the uninsured ice storm costs would be substantial, the Company had the opportunity to request rate relief or deferral of these costs for future recovery. It did neither.

Though the circumstances surrounding the events in these two cases are different from that of United Water, the concept of recovery of past expenses is relevant. The substantial costs of the early retirement plan were incurred in 2000 and the Company did not request nor receive approval from this Commission to defer those costs. The Company did however send a letter in December 2001 to the Commission notifying it of those costs and stating their intent to recover those costs in a future rate case. However, the Company did not seek, nor did the Commission grant, approval of the deferral of the early retirement costs, a procedure clearly established by precedent.

Furthermore, the Company's internal policies regarding deferral of expenses states that "in instances involving large dollar amounts or out of the ordinary circumstances, Regulatory Business will seek an accounting order from the Commission to ensure acknowledgement and thereby reduce the risk of not recovering the expense." Certainly, the amount deferred involved a large dollar amount and was out of the ordinary circumstances, but the Company still did not follow its own procedures and request approval from this Commission. Therefore, Staff has removed the $1,250,617 from deferred balances and adjusts the Company's amortization expense by $257,734.

Q. What is Staff's position regarding the amortization of the 1999 early retirement plan that was approved in the Company's last general rate case?

A. Staff does not take a position regarding the deferral of the 1999 early retirement costs. However, the remaining unamortized balance of those 1999 expenses is $38,052. The Company was allowed to recover in rates

$152,208 per year from the 1999 ERP, and it will clearly have recovered all costs associated with the 1999 ERP by the time new rates go into effect. Therefore, Staff also has removed the remaining unamortized balance of the 1999 ERP from the Company's Application to ensure that the Company does not over recover those expenses in customer rates.

Q. Do Staff's arguments related to removing the ERP amortization apply to the Deferred Enhanced Severance Package (ESP) Expense shown on Schedule No. 8 of Exhibit No. 108?

A. Yes. The Enhanced Severance Plan should have also been self-funding or it would not have been prudent for the Company to incur these expenses. Also, the same arguments regarding precedent for utilities to defer expenses and recover them later through rates applies. The Company has not received authority from this Commission to defer these expenses and thus, Staff had to remove from the Company's request $49,751 of ESP amortization expense.

Q. Please explain Schedule No. 9 of Exhibit No. 108?

A. Schedule No. 9 illustrates Staff's removal of $77,479 from the Company's pro forma purchased water costs. These adjustments were made to reduce the amount of purchased water to a level that appropriately aligns with water usage in a typical year. Staff witness Sterling will address this adjustment in further detail.

Q. Would you please explain Schedule No. 10 of Exhibit No. 108?

A. Schedule No. 10 illustrates Staff's adjustment to deferred tank painting expenses. Staff does not take exception to the inclusion of the amortized costs of deferred tank painting. The issue here is the length of time that the expenses should be amortized. The Company proposes to recover tank painting expenses over a ten-year amortization period. Staff was not completely satisfied that a ten-year amortization period is appropriate and inquired of the Company in Production Request No. 168 to provide a list of all tanks painted within the last twenty years. The Company's response indicated that only one tank, the North Mountain tank on 24th Street in Boise, was painted twice during the last twenty years, once in 1984 and again in 1999. Since tanks are not being painted every ten years, Staff believes that a ten-year amortization period is not appropriate.

When determining an amortization period, it is important to take into consideration the estimated life of the service or asset that is being amortized or depreciated. The concept is to match the benefit received by the Company to the life of the asset or service. In this case, it is not appropriate for customers to pay through rates the expenses of painting tanks every ten years when they clearly do not need painting that frequently. Therefore Staff proposes the use of a twenty-year amortization period and adjusts the Company's amortization expense by $3,046 to reflect this.

Q. Would you please explain Schedule Nos. 11-13 of Exhibit No. 108?

A. Schedule No. 11 illustrates Staff's removal of $260,042 of purchased power costs from the Company's Application. Schedule No. 12 illustrates Staff's adjustment to the amortization of deferred power costs related to Idaho Power Company's PCA mechanism above the level of power expense established in Case No. UWI-W-00-1, Order No. 28505. This adjustment effectively ends the date of the Company's deferral at April 30, 2003 and amortizes the deferred balance over four years, resulting in a decrease to the Company's pro forma amortization expense of $258,142. It should also be noted that because the Company was awarded a carrying charge on the deferred balance, Staff has removed the deferred balance from rate base. The Company should not be allowed to earn a rate of return on the deferred balance in addition to the carrying charge.

Schedule No. 13 illustrates Staff's adjustment to chemical expense, removing $15,000 from the Company's Application for the normalization of phosphate usage. Staff witness Sterling will discuss these three adjustments in further detail in his testimony.

Q. Would you please explain Schedule No. 14 of Exhibit No. 108?

A. Schedule No. 14 illustrates Staff's adjustment to Outside Laboratory expense. Staff reviewed the expense levels of water quality testing for years 1999-2004 and the estimated expense levels through 2011. Staff also examined the frequency of each test to determine if the tests included in the Company's filing are reflective of a typical year. Staff accepts the Company's adjustment to test year expenses for the following tests on Schedule No. 14.

Line No.	Test
3a.	Inorganic Chemicals
3b.	Volatile Organic Chemicals
3c.	Synthetic Organic Chemicals
3d.	Nitrates
3g.	Arsenic
3h.	Radionuclides
3i.	Disinfection By-Products
3j.	Coliform

Q. Why does Staff disagree with the Company's proposed expenses for the other tests?

A. According to the Company's response to Staff Production Request No. 98, testing for nitrites is only done once every nine years. Rather than letting the Company recover the costs of this test from customers each year, Staff believes it is appropriate for the Company to only recover 1/9 of the expense of this test each year.

The same response indicated that the testing for Fe/Mn is not regulated and for aesthetic purposes only. Though Staff agrees this test is necessary, the amount proposed by the Company exceeds the amounts actually incurred by the Company in any of the previous six years. Staff accepts the 2004 level of expense for this test of $738, which is in line with the five-year average of $742.

The LT2ESWTR test, which tests for Cryptosporidium, E. Coli, and turbidity is required bi-monthly for only two years. Staff believes it would be inappropriate for the Company to recover these expenses from customers every year when after two years the tests are no longer required. Staff believes allowing the Company to recover 1/5 of the $12,000 annual expense of this test each year, or $2,400, is reasonable.

Also included in the Company's pro forma expenses is $3,500 for miscellaneous testing which represents repeat or response samples. The Company did not provide the historical costs of miscellaneous testing expenses with its response to Production Request No. 169, which asked for a 10-year history of all testing expenses included in this case. Though Staff understands the occasional need for a repeat test or response sample, we were unable to determine with any certainty the amount of miscellaneous testing expense that will be incurred in the future. Based on the Commission's precedent that future expenses be known and measurable, Staff has removed the $3,500 miscellaneous expense for these tests. The total amount removed from the Company's pro forma water quality testing expense is $14,340.

Q. Please explain Schedules No. 15 and 16 of Exhibit No. 108?

A. Schedule Nos. 15 and 16 duplicate Mr. Healy's Exhibit No. 3, Schedule 1, pages 15 and 16, where the Company proposes adjustments for increased operating expenses related to the new Columbia Water Treatment Plant and decreased power and chemical expenses at other sites because of the operation of the new treatment plant. Staff witness Sterling examined these expenses and Staff accepts the Company's adjustments.

Q. Please explain Staff's adjustment to transportation expense shown on Schedule No. 17 of Exhibit No. 108.

A. The Company's adjustment to test year transportation expense includes mechanic payroll and benefits. Those amounts have already been accounted for in Adjustment No. 1 (Payroll), Adjustment No. 3 (Employee Health and Other Insurance), and Adjustment No. 4 (Pension Expense). The inclusion of mechanic payroll and benefits in Transportation expense would allow the Company to recover from customers twice the expense it would actually incur. Thus Staff has removed the mechanic payroll and benefits from Transportation expense. The Company is aware of this adjustment and provided an updated amount as part of the response to Staff Production Request No. 198.

Staff also takes exception with the calculation of lease disposal proceeds in the Company's filing. The Company estimated the total net value of the vehicles with leases expiring in 2005 to be $31,442. However, the Kelley Blue Book wholesale value of those vehicles is $53,300. Kelley Blue Book is an independent, objective vehicle valuation service. Staff believes that the Kelley Blue Book value is more indicative of the net value of the vehicles than United Water Idaho's estimate for 2005 and should therefore be used in determining the proceeds from the lease disposals. The total amount removed by Staff from the Company's Application for transportation expense is $18,661.

Q. Please explain Schedule No. 18 of Exhibit No. 108.

A. Schedule No. 18 illustrates the Company's adjustment to test year expenses for customer postage. The Company uses an estimated customer count as of May 31, 2005 to determine the annual postage expense to be recovered in rates. Though this amount is only an estimate and not known with any certainty, Staff accepts this adjustment. The inclusion of the Columbia Water Treatment Plant and the associated revenue producing adjustments as discussed by Staff witness Lobb supports the rationale for accepting this adjustment.

Q. Please continue with the explanation of your adjustments and schedules.

A. Schedule No. 19 reflects the Company's adjustment to test year expenses for customer information system (billing) expenses and incorporates Staff's adjustments. Again, the Company uses a pro forma customer level at May 31, 2005 as the basis for its computation of billing expense. Staff accepts the May 31, 2005 customer count per Staff witness Lobb's testimony, however Staff disagrees with the number of past due notices the Company uses in its calculation. The Company uses an estimated number of 7,386 past due notices per month or 88,635 per annum. The average number of past due notices mailed per month during the test year was 7,153 or 85,839 per annum. Since it would be impossible to determine the exact amount of past due notices that will be mailed in any given year, Staff replaces the Company's estimate with the actual test year number. The effect of this change reduces the Company's pro forma adjustment by $1,678.

Schedule No. 20 illustrates Staff's adjustment to the Company's pro forma customer outside collection expense. The Company uses a test-year level of lockbox transactions and multiplies that by the pro forma number of bills produced based on May 31, 2005 customer counts. The price per unit of lockbox transactions was also based on the test year level of 23.44 cents per transaction. However, the Company indicated in its response to Staff's Production Request No. 172 that the actual cost per unit of lockbox transactions as of December 31, 2004 is 14.77 cents. Staff accepts the Company's calculation with the provision that the December 31, 2004 lockbox price is used. The result is an adjustment to the Company's filing of $30,015.

Schedule No. 21 is similar to Mr. Healy's Exhibit No. 3, Schedule 1, page 21 of 34 and illustrates the Company's adjustment to test year expenses for customer records and collection expense and miscellaneous customer accounting expenses. Staff has reviewed these calculations and accepts the Company's adjustment as filed.

Schedule No. 22 is duplicative of Mr. Healy's Exhibit No. 3, Schedule 1, page 22 of 34 and reflects the Company's adjustment to Uncollectible Accounts expense. The Company indicates that the uncollectible debt percentage during the test year was abnormally high, so it used a four-year average to attempt to normalize the expense. Staff is concerned with the arbitrary use of the four-year average because the Company seems to purposefully exclude years prior to 2001 where the percentage of bad debt is significantly lower. By using a five-year average, the uncollectible debt rate is .3978% as opposed to .41565% as filed in the case. A six-year average reduces the bad debt rate to .3917%, and a ten-year average reduces the bad debt rate to .366% percent. Staff's calculation uses the five-year average of .3978%, which reduces the Company's filing by $5,529.

Schedule No. 23 reflects Staff's response to the Company's adjustment to increase test year expenses for the IPUC annual assessment. The Company uses the 2004 assessment rate of .240500% and multiplies that rate by pro forma revenue. Staff believes that this result only produces an estimate, and not a known and measurable amount and objects to the Company's adjustment. Staff is aware that the annual assessment to be paid by United Water Idaho is likely going to increase over the 2004 levels but cannot determine with certainty the exact amount. However, by the time the Company files its rebuttal, the actual assessment amount will be known. Staff is willing to accept and incorporate the actual assessment amount into its revenue requirement if the Company files that amount on rebuttal.

Q. Please explain Staff's adjustment to the amortization of rate case expenses as shown on Schedule No. 24 of Exhibit No. 108.

A. The Company estimated the expenses that it will incur with regard to this current rate case at $245,000 and requested a three-year amortization period to recover those costs. Staff reviewed the invoices of all expenses incurred through March 21, 2005, which totaled $183,074. The Company estimates remaining expenditures to be $62,500, which would bring the total rate case expenses to $245,574.

Included in the Company's $245,000 estimate was $25,000 to Steele & Associates - Boise (S&A-B) for a public information campaign and website enhancement. Staff understands the need for the Company to inform customers of the pending rate case, but also believes that much of the public relations performed by S&A-B also enhances the Company's image and goodwill. Therefore, Staff believes a split of the expenditures is appropriate, and the Company should only recover 1/2 of the expense from customers. By removing 1/2 of the S&A-B estimated expenditures, the remaining balance to be recovered and amortized is $232,500.

Secondly, as with any requested amortization, Staff reviewed the amortization period. Staff notes that Idaho Power Company incurred similar outside consulting expenses in its last general rate case, Case No. IPC-E-03-13, and the Commission accepted in Order No. 29505 a five-year amortization period. Staff believes that an amortization period of five years in this current proceeding is not only reasonable, but also consistent with the Commission's recent decision.

The two adjustments noted above will reduce the Company's pro forma amortization expense by $35,167.

Q. Would you please explain Staff's adjustments on Schedule No. 25 of Exhibit No. 108?

A. In 2003, the Company paid $130,093 in Employee Reimbursement expenses for one employee to move to Boise to work for United Water Idaho as a Senior Technical Analyst. This amount is clearly excessive for an employee who was paid a salary of approximately $81,500. Furthermore, Staff believes that the employment pool in Boise is large enough that the Company could have filled this position locally, or promoted from within and thus mitigated the need for such a large expense.

Q. What kind of expenses did the Company incur for the relocation of this employee?

A. The Company paid $14,146 for two months of lodging between April 23, 2003 and June 27, 2003. The Company also paid $36,817 for all costs associated with the sale of the employee's house, $8,452 for storage of the employee's vehicles and personal items, and $7,992 in a lump sum per diem that the employee could spend in any manner he chose. After all the relocation expenses were tallied, the Company then grossed up the expenses for taxes so the employee would not be hit with an additional tax burden. The Company paid the employee an extra $40,671 to help cover the additional tax liability caused by the relocation expense.

Q. Did Staff review the Company's Relocation Policy, and would you briefly describe that policy for the Commission?

A. Yes. The Relocation Policy is extremely generous and indicates that the Company will pay for the following costs associated with the sale of the relocating employee's current home:

- Real estate commission up to a maximum of 6%
- Pre-payment penalties
- Title examination
- Title insurance
- Attorney and escrow fees
- Transfer and recording fees
- Survey fees
- Required inspections

If the relocating employee is currently leasing a home, and cannot cancel the lease without penalty, the Company will reimburse the employee up to an equivalent of one month's rent for canceling the lease.

The Company will also pay for the relocating employee and his/her spouse/partner to make two trips to Boise of up to four nights each for the purpose of finding a new home. The Company covers the lodging, plane tickets, and rental car.

The Company also assists the relocating employee to purchase a new house for up to six months after the date of transfer. The Company pays the following costs associated with the new home purchase:

- Loan origination fee not to exceed 1%
- Title insurance or fees for examination of title as required by lender
- Appraisal of new home
- Escrow and closing fees
- Attorney fees
- Recording fees
- Assumption or transfer fee
- Credit report charges
- Inspection fees

The Company also pays for temporary living expense for up to 60 days, if the new employee is unable to move into the new residence immediately.

The Company will also pay all the expenses of moving the employee and his/her family to their new location, along with the costs of storing any personal items. Relocating employees also receive a Miscellaneous Expense Allowance "to aid in the defraying" of miscellaneous costs associated with the move. These costs include:

- Driver's license and automobile tags
- Miscellaneous personal expenses during temporary living, such as dry cleaning, parking and tolls, entertainment, etc.
- Pet shipping/care/boarding
- Cable TV and telephone removal and installation
- Utility disconnection and connections
- Carpet and drapery installation and cleaning

- Cleaning of old and new residence
- Taxes not covered under the tax gross-up program
- Tips to movers
- Childcare during house-hunting trips
- Meals and phone calls home while in temporary housing
- Laundry while in temporary housing
- All miscellaneous expenses associated with house-hunting trips, temporary living, final move and moving of household goods

After all the relocation expenses have been calculated or incurred, the Company then provides the employee with an allowance to help offset the additional tax burden incurred by receiving the benefit.

Q. What is Staff's position with regard to this policy?

A. Obviously, this policy is very generous. Staff believes the policy to be extremely excessive and not appropriate for a public utility that passes on costs to customers. The policy does not provide a maximum dollar limit that an individual may receive, nor does it provide for any repayments from the employee if the employee terminates soon after relocating.

Q. Is this employee still currently employed by the Company?

A. No, it is Staff's understanding that this employee passed away approximately one year after moving to Boise.

Q. Has the Company replaced this employee?
A. The Company eliminated the position and replaced it with an employee earning $33,200 per year.
Q. Would you briefly summarize Staff's position on the relocation expense?
A. Yes, Staff believes that the Company's relocation policy is excessive and it would be inappropriate to pass on those excessive costs to customers. Staff also believes that pertaining to this specific individual position, the Company could have hired locally or promoted from within. Furthermore, a year after incurring these expenses for the position of Senior Technical Analyst, the Company deemed the position obsolete and replaced it with a much lower-paid position. Therefore, Staff's recommendation is to disallow all expenses associated with this employee relocation expense. It should also be noted that with this adjustment, Staff has decreased the deferred balance of the employee relocation expense from rate base so the Company will not receive a rate of return on the unamortized portion of the expense.
Q. Is the Company including any relocation expense amortization left over from a prior case in this current case?
A. Yes, the Company indicates that the remaining unamortized balance of employee relocation expense left over

from the UWI-W-00-1 case is $5,732. In that case, the Commission granted an annual amortization expense of $25,688. Staff removes the remaining balance of amortized expense from the Company's filing because shortly after the time the new rates go into effect, the Company will have fully recovered its employee relocation expense from the prior case.

Q. Will you please explain the Company's treatment of Business Insurance expense and Staff's adjustment shown on Schedule No. 26 of Exhibit No. 108?

A. The Company includes the costs of casualty insurance, worker's compensation coverage, property insurance, and small property damage claims in its adjustment to Business Insurance expense. The amounts included are derived from the Operating Plan of United Water Resources, Inc. and then allocated to United Water Idaho, with the exception of small property damage claims. The Operating Plan Insurance expense is simply an estimate of insurance expense that it anticipates will increase during 2005. It is likely that some policy premiums will increase while others decrease, and Staff contends that the Company-proposed increases to test year expenses for additional insurance costs are speculative and not based on known and measurable charges.

However, Staff understands that test-year expenses for property insurance coverage are "abnormally low due to a large, non-recurring property insurance credit of $109,271" (Healy, Di, page 21). Staff does not wish to penalize the Company because of this one-time credit and will accept an adjustment to increase test year business expense by $109,271. Staff believes its proposal will compensate the Company for business insurance expense that it expects the Company will incur during a typical year. The impact of Staff's adjustment is a reduction to the Company's pro forma Business Insurance expense of $184,264.

Q. Will you please explain Staff's adjustments on Schedule No. 27 of Exhibit No. 108?

A. Pursuant to Commission precedent, the Company removed from test year expenses $14,005 for charitable contributions, country club dues, and the lobbying portion of industry association dues. Staff recognizes the Company's attempt to comply with previous Commission Orders, however a review of the Company's expenses indicates that the Company did not remove all of these costs. Specifically, the Company spent $3,800 on scholarships and sponsorships and $11,833 on Company sponsored events such as golf tournaments, Christmas parties, and Fourth of July parties during the test year. Staff appreciates the Company's willingness to fund scholarships and sponsor Community events, however these expenses serve to enhance the Company's image rather than improve the production, transmission, and distribution of water, and should not be passed on to customers.

Staff also understands the importance of Christmas parties and Fourth of July parties to celebrate special occasions and increase employee morale, however it is not appropriate to recover these expenses from ratepayers.

Staff also believes the Company understated the lobbying portion of the dues paid to the National Association of Water Companies (NAWC). The 2004 NAWC Dues Schedule, provided as a part of Mr. Healy's workpapers, indicates that 27% of the dues paid are for lobbying expenses. The Company has removed only 18% of the dues from the test year. Staff's adjustment also accounts for the additional 9% of the dues that is allocated to the lobbying expenses of the NAWC. Staff's adjustment along with the Company's adjustment removes $31,438 from test year expenses.

Q. Please explain Staff's adjustments to Corporate and Local Information Technology (IT) Maintenance and Support as shown on Schedule No. 28 of Exhibit No 108.

A. The Company proposed a nearly 50% increase in IT maintenance and support. Staff was concerned with this large increase and asked the Company in Production Request

No. 175 to "provide a detailed narrative justifying the near 50% increase requested for corporate and local IT support." The request also specifically requested the Company to include in its response "all components of the increase and include all contracts or agreements." The Company did not file a response until after Staff had begun writing testimony, and Staff was not able to fully review all the components of the request. Also, the response did not include any contracts or agreements for the costs of this support. However, the response did indicate that the main driver of the increase was the conversion of the financial system software to PeopleSoft 8.4. The conversion of a financial system is a major task that is not a typical occurrence that one can expect to duplicate each year. Therefore, Staff cannot accept the Company's adjustment because of Commission precedent that excludes extraordinary and non-recurring expenses from recovery in rates. Staff would be willing to continue to work with the Company to review the IT Maintenance and Support expense, and could possibly accept an amortization of the increased costs if one is truly warranted.

Q. Please explain Schedule No. 29 of Exhibit No. 108.

A. Schedule No. 29 is duplicative of Mr. Healy's Exhibit No. 3, Schedule 1, page 29 of 34. The Company discovered a test year miscoding on their books and removed $2,995 from test year expense. Staff has reviewed the entries and concurs with the Company's adjustment.

Q. Please explain Staff's adjustments on Schedule No. 30 of Exhibit No. 108.

A. The Company made an adjustment to test year expenses to reflect additional variable expenses related to customer growth. Staff witness Lobb testifies as to the rationale behind these expenses and Staff accepts an adjustment to reflect customer growth. Staff has updated the amounts on Mr. Healy's Exhibit No. 3, Schedule 1, page 30 of 34 to account for updates made to Transportation expense, Purchased Power expense, Chemical expense, and Customer Growth revenue. The latter three expenses were provided to me by Staff witness Sterling. The overall effect of this adjustment is an increase in test year expenses of $56,542, which is $16,480 less than the Company's request.

Q. Would you please explain Staff's adjustment to expenses related to weather normalization as shown on Schedule No. 31 of Exhibit No. 108?

A. Staff witness Sterling will testify regarding these expenses. The effect of the adjustment decreases the variable cost power and chemicals filed in the Company's Application by an additional $1,888.

Q. Please explain the adjustments to outside legal expenses as indicated on Schedule No. 32 of Exhibit No. 108.

A. The Company removed from test year legal expenses $28,851 to recognize the cessation of an amortization allowance granted in the Company's prior rate case regarding property tax valuations. The Company has fully recovered those expenses and removed the amortization expense from test year legal expenses. Staff agrees with the Company that this amount should be removed from rates so as to not over recover the initial expense. During the review of the Company's finances, Staff also discovered other legal expenses that should be removed from test year legal expenses. During the test year, the Company incurred legal expenses of $2,818 related to the disposition of the Company's non-contiguous Carriage Hill system, $248 related to the Cartwright Tank removal, and $7,980 related to Idaho Power Company's operation of the Danskin Power Plant. Clearly, the disposition of Carriage Hill, the removal of the Cartwright tank and Idaho Power Company's building of the Danskin power plant are extraordinary, non-recurring incidents and the Company should not be allowed to recover the legal expenses associated with these items as if they would occur each year in the future.

Also during the test year, the Company incurred $8,374 in outside legal expenses as an intervener in Idaho

Power Company's general rate case IPC-E-03-13. As a regulated utility that consumes large amounts of electricity, United Water cannot curtail its consumption of electricity when power rates increase. Staff appreciates United Water's efforts to serve in the best interests of its customers by intervening in that case, however, it would not be appropriate to pass those legal expenses on to customers in their entirety each year because rate cases of that magnitude do not occur on an annual basis. Staff proposes the Company be allowed to recover one-fifth of the expenses related to the Idaho Power case, in essence granting them a five-year amortization of those expenses. This five-year period is consistent with Staff's arguments regarding United Water Idaho's amortization of the current rate case expenses and is also consistent with Idaho Power's recovery of expenses in that same case.

The total amount of the Staff's adjustment to the Company's Application is $17,745. After Staff's adjustment, approximately $50,000 of outside legal fees remains in the test year.

Q. Would you please explain the adjustment to the amortization of deferred legal expenses illustrated on Schedule No. 33 of Exhibit No. 108?

A. The Company has requested in this case to defer and recover $4,707 in legal expenses it has incurred related to its efforts to assist the Commission with the challenges posed by the Terra Grande Water Company (Healy, Di, pg 23). Staff appreciates the Company's efforts and assistance and agrees that the Company should be able to recover these expenses over time. Consistent with previous arguments made in my testimony, Staff believes a five-year amortization period is appropriate.

The Company's response to Staff Production Request No. 137 states that "Mr. Healy's testimony failed to recognize that $829.35 of the total deferred amount is actually attributable to Company labor and benefits overhead actually expended on efforts related to due diligence including wells and facilities inspection and line locating at Terra Grande during the Summer of 2004." Since labor and benefits overhead have already been accounted for in other adjustments, it would not be appropriate for the Company to include this amount in its deferral. Staff supports the recovery of the $3,877 deferral over a five-year amortization period. The result of Staff's adjustment reduces the amortization expense by $794. Staff has also reduced the deferred balance included in rate base to $3,877 so the Company will not receive a rate of return on the expended labor and benefits overhead.

Q. Would you please explain Staff's adjustments calculated on Schedule No. 34 of Exhibit No. 108?

A. The Company reduced test year operating expenses by $986 to account for the reduced power costs due to cessation of its operation of the Carriage Hill system (Healy, Di, pg 23). On page 24 of his direct testimony, Mr. Healy states that the accounting expense is negligible, and therefore the Company did not make an adjustment to reflect the reduced accounting expense. Mr. Healy's workpapers indicate that the test year accounting expense related to the Carriage Hill system was $645. Because the Company includes an adjustment for the disposition of the Carriage Hill system and substantiated the total dollar amounts involved, it is only appropriate to make an adjustment that reduces all of the test year expenses related to the operation of the Carriage Hill system. Therefore, Staff's adjustment reduces the test year expense by an additional $645 to account for the decreased accounting expense that will no longer be incurred due to the sale of this system.

Q. Will you please explain Exhibit No. 109?

A. Exhibit No. 109 consists of three schedules that illustrate the calculation of payroll taxes. These schedules and calculations are similar to Exhibit No. 3, Schedule 2, pages 2-4 sponsored by Mr. Healy. Staff has updated these schedules to reflect the adjustments made to payroll chargeable to Operations & Maintenance. The effect of Staff's adjustment reduces the Company's proposed

Employer FICA and Medicare Tax Liability by $16,308, the proposed State Unemployment Insurance Tax Liability by $59, and the proposed Federal Unemployment Insurance Tax Liability by $56.

Q. Does this conclude your direct testimony in this proceeding?

A. Yes, it does.