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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AN AMENDMENT TO ITS CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY NO. 143 AND FOR AN ACCOUNTING ORDER	**CASE NO. UWI-W-07-5** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Scott Woodbury, Deputy Attorney General, and in response to the Notice of Application, Notice of Modified Procedure and Notice of Comment/Protest Deadline issued on October 10, 2007, submits the following comments.

BACKGROUND

On September 28, 2007, United Water Idaho Inc. (United Water; Company) filed an Application with the Idaho Public Utilities Commission (Commission) requesting approval of a July 26, 2007 Purchase and Sale Agreement (Agreement) between United Water and the City of Kuna. The subject matter of the Agreement is the sale by United Water to the City of a non-contiguous water system presently serving Danskin Ridge, Saddle Ridge and Iron Horse Subdivisions (Danskin-Saddle Ridge system). Reference Case No. UWI-W-00-2, Order No. 28377 (May 16, 2000).

Pursuant to the Purchase and Sale Agreement filed with the Commission, the purchase price for the Danskin-Saddle Ridge system is $375,000. United Water estimates that the net gain at closing will be approximately $212,255. Kuna has agreed to assume the Company's outstanding obligations under the Non-Contiguous Agreement and Main Line Extension Agreements with other third parties and to hold United Water harmless from further obligations thereunder.

United Water contends that acquisition of the Danskin-Saddle Ridge system by Kuna is consistent with the public convenience and necessity because the customers will obtain water service from a dependable municipal supplier (Kuna) at rates that are lower than United Water's rates. In addition, when Kuna connects the Danskin-Saddle Ridge system with its existing municipal system, the customers will experience improved redundancy for both domestic and fire protection flows.

United Water recommends proposed journal entries to account for the sale. The Company further requests a determination that gain or profit associated with the transfer is the property of United Water and that its customers do not have an interest therein.

United Water requests a Commission Order

- Approving the modification of United Water's Certificate of Public Convenience and Necessity No. 143 by eliminating the Danskin-Saddle Ridge system therefrom;

- Confirming that after the date of closing of the purchase and sale transaction, United Water will have no further obligation to provide domestic water service to the Danskin-Saddle Ridge system customers;

- Confirming that following the assumption by Kuna of the Non-Contiguous Agreement and the Main Line Extension Agreements, United Water will have no further obligations thereunder;

- Approving the Company's accounting proposal and determining that gain arising from the transfer is the property of United Water.

The Company's Application in this case includes a map of the Danskin-Saddle Ridge water system, a copy of the Agreement for Purchase and Sale between the Company and the City of Kuna, proposed journal entries, a notice to customers, and the supporting direct testimony of Gregory P. Wyatt, Vice President and General Manager of United Water Idaho.

ANALYSIS

Staff has reviewed United Water's Application requesting approval to sell its non-contiguous Danskin-Saddle Ridge water system to the City of Kuna. Staff supports this sale and recognizes Kuna's ability to provide adequate water service at a reasonable price. The $375,000 purchase price for the system was the culmination of an arms length negotiation between UWI and the City of Kuna. Staff's comments primarily address the Company's proposed treatment of the gain associated with this sale.

The Danskin-Saddle Ridge system was established in 1999 through a Residential or Multiple Family Housing Non-contiguous Water System Agreement (Non-contiguous Agreement) between UWI and the developers. The Commission approved the Non-contiguous Agreement in Case No. UWI-W-00-2 (Order No. 28377 dated May 16, 2000). The Commission found that the submitted Non-contiguous Agreement with the owner/developer of Danskin Ridge and Saddle Ridge Subdivisions and UWI to be acceptable with certain clarifications. Those clarifications included that the developer was to pay for any additional well and related equipment required and necessary to serve customers within Danskin Ridge and Saddle Ridge Subdivisions and that the reimbursement period be limited to 15 years.

The distribution system and water source was contributed to UWI as part of that Non-contiguous Agreement. UWI booked the system value to plant in service for rate base treatment with two contra balances. The first contra balance that reduces rate base is for the value of the distribution system (mains, services and hydrants) and is entitled contributions in aid of construction. The second contra balance that reduces rate base is for the source supply (wells) and is entitled advances in aid of construction.

In accordance with the Non-contiguous Agreement, UWI reimburses the developers at a rate of $800 per lot once a customer connects to the system and begins taking service. The reimbursement rate was established in Case No. UWI-W-98-1, Order No. 27718, as the average embedded per customer cost of supply improvements within UWI's entire Idaho service area. The total reimbursement amount is limited to the lesser of the total number of connected lots or the total advance in aid of construction. Reimbursements are also limited to a maximum of 15 years.

The reimbursement described above reduces the amount originally recorded to advances in aid of construction and as a result increases UWI's depreciable rate base. At the same time, UWI's rate base is increased by its cost to install meters when a customer connects to the system. UWI's rate base also increased by $28,865 when it provided auxiliary power to the system and by $39,160 when it studied the need and possible method for uranium mitigation at the site. These costs (approximately $70,000) were not paid by the developer.

In 2006, Danskin-Saddle Ridge customers paying standard UWI rates each contributed approximately $260 per year per customer. The reimbursements made to the developer are based upon an average contribution per customer of $335 as identified in the Non-contiguous Agreement (Exhibit C, Page 12 of 34). Therefore, the revenue from customers required to support the reimbursements to developers for the Danskin-Saddle Ridge system is approximately 29% higher than the average revenue provided by Danskin-Saddle Ridge customers. The $800 reimbursement was appropriately paid based upon the rules and regulations in place at the time the Non-contiguous Agreement was executed, but the revenue comparison indicates that the Danskin-Saddle Ridge system has not provided sufficient revenue to support the Company's investment.

The Danskin-Saddle Ridge system is included in UWI's current rate calculation for all customers of UWI. Two general rate cases have occurred since the approval of the Danskin-Saddle Ridge non-contiguous water system. UWI does not currently have a general rate case proceeding before the Commission.

The Company has argued the transaction should be treated as a liquidation of a stand-alone water system and as such, the shareholders are entitled to the gain/profit/risk premium in the sale. While it is true that Danskin-Saddle Ridge is a non-contiguous system, the Company is not liquidating itself as a whole. The Danskin-Saddle Ridge non-contiguous system is not a legal entity separate from UWI. Further, the assets and expenses associated with Danskin-Saddle Ridge are part of the rates charged to all customers of UWI, not a separate entity. As noted previously, the rules and regulations for establishing such non-contiguous systems are based on averaged costs and revenues of the United Water Idaho system as a whole.

Staff considered three methods to treat the gain associated with the sale of its Danskin-Saddle Ridge non-contiguous system to the City of Kuna. The first methodology treats the gain as regulated revenue to be passed through to customers during the Company's next general rate case and is Staff's recommended treatment. The second methodology records the gain from the sale as an offset (reduction) to UWI's regulated Plant in Service. The third methodology allocates the gain from the sale of UWI's depreciable assets between UWI's shareholders and ratepayers.

The first methodology, Staff's recommendation, treats the gain from this sale as regulated revenue to be passed through to customers during the Company's next general rate case similar to the most recent sale of a UWI non-contiguous system (Carriage Hill). The sale of Carriage Hill was the subject of Commission Order No. 29625 dated November 9, 2004 in Case No. UWI-W-04-03. In that case, the Commission found that:

> Both Staff and the Company present proposals for the allocation of the sale proceeds. While other allocation methods have merit, we find the Company's proposal to simply unwind the financial obligations to be reasonable. In so doing, we find it unnecessary to address the legal and property right arguments advanced by Staff and the Company.... We further find it reasonable and direct United Water to book the $28,138 amount originally proposed as a risk premium distributed to United Waterworks as regulated revenue to be passed through to customers in the Company's upcoming general rate case. With such accounting, we find that the Company's remaining customers are held harmless.

The risk premium referenced in Order No. 29625 was an amount proposed by UWI to be paid to its parent, United Waterworks (UWW), above and beyond the satisfaction of UWW's loan to the developers of the non-contiguous system being sold. In Greg Wyatt's UWI-W-04-03 testimony this risk premium was also referred to as profit in the sales price of the system. Similarly, if the Danskin-Saddle Ridge transaction is simply unwound then the profit/gain in the sale price should be treated as regulated revenue in the Company's next general rate case. As the Company does not have a current general rate case before the Commission, Staff recommends that the gain from this sale (estimated at $212,255 according to the Company's Exhibit C) be established in a deferral account and amortized over a period of three years. This amortization period is to reflect the average time between recent rate cases. The amortization each year would be approximately $71,000 based upon a gain of $212,255.

In addition to treating the gain in this case similarly to that ordered in the most recent sale of a UWI non-contiguous system, this treatment recognizes that UWI's ratepayers also support the operations of non-contiguous systems such as Danskin-Saddle Ridge to the degree that revenues from those customers do not meet the revenue requirement (recovery on investment, operating expenses and taxes) demanded by that system. According to UWI audit responses, the Danskin-Saddle Ridge project would need to earn approximately 45% more revenues that it currently does in order for the system to be "self-supporting" and earn UWI's overall authorized rate of return. According to UWI, the Danskin-Saddle Ridge system is currently earning approximately 3% return on rate base. This is well below the 8.357% return authorized in Case No. UWI-W-04-4, Order No. 29838, page 28 and the approved settlement in Case No. UWI-W-06-2, Order No. 30104.

The second methodology records the entire gain from the sale as an offset (reduction) to UWI's regulated Plant in Service in the Company's next general rate case. Similar to the first methodology, this accounting holds the Company's remaining customers after the sale harmless by treating the gain as a reinvestment in the system. In this methodology customers are held harmless by reducing UWI's regulated Plant in Service by offsetting capitalized water rights in the amount of the gain from this sale (estimated at $212,255 according to the Company's Exhibit C). This treatment recognizes that resolution of certain water rights issues between the parties was a consideration in agreeing to the sale. The reduction in return due to the reduced rate base produces the benefit to customers. In the first year this reduced revenue requirement would be approximately $30,000.

The third methodology considered develops ratios where the depreciated portion of the depreciable asset is allocated to the ratepayers and the undepreciated portion of the asset is allocated to UWI shareholders. Under this methodology, the ratepayers' share of the gain, at a minimum, should be equal to the ratio that accumulated depreciation is to the net book value of the system's depreciable assets. That ratio is represented as below.

Accumulated Depreciation	$ 14,265
Net Book Value of Depreciable Assets	$135,255

Thus, as a minimum, the ratepayers should be entitled to 11% of the gain after UWI is first made whole or approximately $23,000 based upon Exhibit C of its Application. Staff has reduced Exhibit C's Net Company Investment ($71,072 and $76,673) by the Net Company Investment attributable to land ($12,490). Under this methodology the "ratepayer" gain would be credited to Account 253.xx Other Deferred Credits - Danskin sale gain. The unamortized amount in this account would be deducted from rate base, thereby reducing rate base by the gain amount. Should the Commission adopt this methodology, Staff recommends a three-year amortization period. This amortization period is to reflect the average time between recent rate cases. The amortization each year would be approximately $7,500. This methodology is similar to that used for disposition of the gain on the sale of the Centralia steam generating plant in Case Nos. AVU-E-99-6 and PAC-E-99-2 (Order Nos. 28297 and 28296).

This methodology evaluates only the proceeds associated with rate base investment that UWI has made and that is being depreciated. This methodology ignores the contributions and advances associated with the system. Originally, a majority of the Danskin-Saddle Ridge water system was contributed and only became rate based as advances were refunded. In this case a majority of the assets were contributed as opposed to entirely rate based. UWI made no investment as to contributed amounts and only minimal investment otherwise. In determining how the gain is to be shared, it is reasonable to consider who has borne the financial burdens and risks. This methodology does not do that and is therefore inappropriate.

RECOMMENDATIONS

Staff does not object to the sale of the Danskin-Saddle Ridge water system to the City of Kuna. However, Staff recommends that the gain from that sale be accounted for as discussed in this document.

Staff recommends that the gain be credited to ratepayers by treating the gain on the sale as regulated revenue that is deferred and amortized over a three-year period. As discussed in Staff's comments, treating the gain on the sale as regulated revenue is consistent with the Commission's most recent order relating to the sale of a non-contiguous water system (Order No. 29625 dated November 9, 2004 in Case No. UWI-W-04-03).

Staff recommends that UWI be required to file (1) a copy of the Closing Documents and (2) a copy of the accounting entries with this Commission within seven days from the completion of the sale.

Staff recommends that the final disposition of the sale be audited as part of UWI's next general rate case as the sale has not closed at the date of these comments and it is expected that the actual gain on the sale will differ from that estimated in the Company's original Application.

Staff recommends that UWI, in its next rate filing, ensure that all components associated with this sale are excluded from that filing including but not limited to: rate base components including overheads and expenses such as legal expenses.

Respectfully submitted this 30th day of November 2007.

Scott Woodbury
Scott Woodbury
Deputy Attorney General

Technical Staff: Patricia Harms

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 30TH DAY OF NOVEMBER 2007, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. UWI-W-07-05, BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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