BEFORE THE

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IDAHO PUBLIC UTILITIES COMMISSION

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IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES IN THE STATE OF IDAHO.	CASE NO. UWI-W-09-01

DIRECT TESTIMONY OF RANDY LOBB IN SUPPORT OF STIPULATION

IDAHO PUBLIC UTILITIES COMMISSION

JANUARY 28, 2010

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

A. My name is Randy Lobb and my business address is 472 West Washington Street, Boise, Idaho.

Q. By whom are you employed?

A. I am employed by the Idaho Public Utilities Commission as Utilities Division Administrator.

Q. What is your educational and professional background?

A. I received a Bachelor of Science Degree in Agricultural Engineering from the University of Idaho in 1980 and worked for the Idaho Department of Water Resources from June of 1980 to November of 1987. I received my Idaho license as a registered professional Civil Engineer in 1985 and began work at the Idaho Public Utilities Commission in December of 1987. My duties at the Commission currently include case management and oversight of all technical Staff assigned to Commission filings. I have conducted analysis of utility rate applications, rate design, tariff analysis and customer petitions. I have testified in numerous proceedings before the Commission including cases dealing with rate structure, cost of service, power supply, line extensions, regulatory policy and facility acquisitions.

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

A. The purpose of my testimony is to describe the terms of the filed Stipulation (the Proposed Settlement) signed by all three parties in this case and to explain the rationale for Staff's support.

Q. Please summarize your testimony.

A. Based on Staff's review of United Water Idaho's (United Water; Company) rate case filing, a comprehensive audit of Company test year results of operations and consideration of outstanding rate case issues, Staff believes that the proposed Settlement agreed to by Staff, the Community Action Partnership Association of Idaho (CAPAI) and the Company is in the public interest and should be approved by the Commission. The Company originally proposed an annual revenue increase of $5.63 million for an overall increase of 15.21%. With updated numbers, the revenue request became $6.14 million, or 16.6%. The proposed Settlement specifies an annual revenue requirement increase of $3.66 million or 9.9% on March 1 of this year and an additional increase of $640,000 or 1.73% effective February 1, 2011. The Stipulation also prohibits another general rate filing before June 1, 2011.

The primary consideration of the Commission Staff in negotiating the Stipulation was to obtain the best deal possible for United Water customers under current circumstances. Staff's evaluation of the Company's filing revealed that its increased revenue request was driven primarily by needed replacement of aging infrastructure and increased power costs. This limited the potential for reasonable adjustments at hearing, increased the risk that adjustments would not be accepted by the Commission and made the outcome highly uncertain. Given the depressed state of the local economy and the unlikelihood of achieving a better result through hearing, Staff negotiated a comprehensive agreement that included spreading the increase over time, providing rate stability through a rate moratorium and most importantly providing significant reduction in the revenue increase as compared to that requested by the Company.

The Stipulation

Q. What are the key components of the proposed Settlement Stipulation?

A. The key components include: 1) recommending an overall annual revenue requirement increase of $4.3 million or 11.63% over a two-year period with $3.66 million or a 9.9% increase becoming effective on March 1, 2010 and another $640,000 or 1.73% increase effective on February 1, 2011; 2) no change in rate design and a uniform percentage increase in all customer charges and volumetric rate components; 3) a rate case moratorium whereby United Water agrees not to file a general rate case prior to June 1, 2011; and 4) continued deferral of Idaho Power PCA costs through March 1, 2010 with amortization over a three-year period and continued deferral of PCA costs with carrying charges for future amortization.

Q. What other provisions are specified in the Stipulation?

A. The Stipulation also specifies amortization of several additional deferred expenses including Rate Case Expense, Tank Painting, the Company's Water Conservation and Implementation expense, and continuation of existing amortizations. Other provisions include establishing a budget Bill Plan that provides for voluntary equal billing and payments on a monthly basis, modification of United Water Rules to clarify the definition of Private Fire Service Line connections and convening an informal workshop to discuss the UW Cares and other issues affecting low income customers.

Revenue Requirement

Q. Would you please describe the process used by Staff to review the Company's filing?

A. Yes. Staff began its review of the Company's filing by identifying the expense and investment drivers behind the Company's requested revenue increase. Staff conducted an account by account trend analysis from the last rate case in 2006 to date and submitted 247 production requests for Company response. Staff audited Company books to verify investment and expenditures, evaluated test year proforma adjustments for reasonableness and assessed investment and expenditure decisions for prudency.

Q. What did Staff find as a result of its review?

A. Staff determined that 71% of the requested increase was due to routine plant investment and increased power costs. The remainder was for increases in wages and operation and maintenance (O&M) expense. The routine investment over the period consisted primarily of replacement of aging infrastructure. The trend analysis showed that total booked O&M expense changed by about 6.5% from December 31, 2006 through May 31, 2009, or about 2.6% per year.

Staff also noted that 40% of the $5.63 million requested increase was due to the gross-up for income taxes on the revenue requirement associated with actual investment and expense increases. Finally, with the true-up of the Company's estimated test year costs to actual costs incurred, Staff determined that revenue requirement could increase in this case from the 15.21% increase originally requested to 16.6%.

Q. What areas did Staff identify for possible adjustments that reduced Company revenue requirement?

A. Staff identified over twenty individual areas for potential adjustment. The main areas can be categorized as: 1) Power Supply, which includes weather normalization, purchased water and customer levels; 2) Salaries and Incentives, which include proposed 2010 increases, 2009 actual increases and 2009 bonuses and incentives; 3) Affiliate costs such as R&I Alliance, Management and Services contracts and Leakguard; 4) Miscellaneous expenses such as recognition expenses, vehicle allowance and manager expenses; and 5) Cost Controls which includes rate case cost sharing and capping the increase in annual expenses. The Company's requested Return on Equity (ROE) of 10.4% was not contested by Staff and was not adjusted.

Q. Would you characterize Staff's review in this case as typical of those conducted by Staff in past United Water rate cases?

A. Staff's review in this case was typical with respect to the comprehensive audit and evaluation of Company investment and expenditures. However, the magnitude of the requested increase (15.21%) coupled with harsh local economic conditions of high unemployment (9.1% Boise Metro) and declining wages (-2.6% Idaho) made Staff's review somewhat atypical with respect to the type and magnitude of revenue requirement adjustments identified.

Q. What do you mean by atypical with respect to type and magnitude of adjustments?

A. With local economic conditions in mind, Staff's review of potential adjustments was more aggressive and creative than usual. However, Staff also had to consider service quality requirements and adequate recovery by the Company of reasonable operating costs. For example, Company investment associated with water quality and system reliability was identified by Staff as a high priority and subjected to little adjustment. The same is true for recovery of power supply cost actually incurred by the Company to operate its system. The remaining cost categories associated with salary and O&M expenses were broadly targeted for review and adjustment at levels that Staff has not previously considered in a United Water general rate case.

Q. Could you provide some examples?

A. Yes. In past cases, Staff has identified proposed salary increases beyond the test year and recommended removal of the entire amount from revenue requirement. In this case Staff not only targeted proposed salary increases, it also targeted all actual test year salary increases and incentive pay. The 2009 salary adjustment totaled over $500,000.

Staff also targeted all previously unadjusted expense accounts and applied a 3% growth limit from 2008 through 2009. This adjustment totaled over $300,000.

Finally, Staff targeted for removal all affiliated R&I Alliance research fees regardless of the nature of the research or Company cited benefit. In addition, Staff applied a 10% across the board reduction in affiliated Management and Services contracts. These adjustments totaled over $400,000.

Q. How did Staff determine that a negotiated settlement in this case could be more beneficial than proceeding to hearing?

A. Staff reviewed each of the 22 identified adjustments to assess the likelihood that they would be accepted by the Commission at hearing. Some adjustments were determined to have a high probability of being accepted by the Commission based on past Commission orders. Other adjustments would clearly be opposed by the Company through rebuttal testimony and cross examination and were more likely to be rejected by the Commission. For example, the portion of Staff's salary adjustments that removed negotiated contract labor salary increases may not have been accepted by the Commission. Based on Staff's review and the identified risk of obtaining adjustments at hearing, Staff determined that negotiated settlement could provide a more beneficial outcome.

Q. What level of adjustment did Staff believe had a high likelihood of approval by the Commission at hearing?

A. Before the likely Staff adjustments were subtracted from the Company requested revenue increase, Staff believed the estimated test year expenses such as property taxes would be trued up to actual. After the true-up, the starting point of the revenue requirement increase would be $6.14 million or 16.6% rather than the $5.63 million or 15.21% originally requested by the Company.

Staff identified approximately $1.45 million in adjustments that the Commission has considered at hearing in the past and has accepted at least in part. There is no guarantee that all of these proposed adjustments would be accepted by the Commission in this case. In fact, it was likely that at least a portion would be rejected. If all of the adjustments would have been accepted, the resulting increase would still have been 12.66%.

Q. What is the level of revenue requirement adjustment and the ultimate overall increase proposed in the Stipulation?

A. The Stipulation specifies an overall revenue increase of $4.3 million (11.63%) over two years with the first $3.66 million (9.9%) effective on March 1, 2010, and an additional $640,000 (1.73%) effective on February 1, 2011. The overall proposed revenue reduction from the total request expected at hearing is $1.84 million. The first year increase is $2.48 million less than the expected request.

The first year revenue increase of $3.66 million represents about 60% of the increase request expected at hearing. The first year adjustment also represents approximately 96% of the total adjustments Staff considered in this case. Consequently, Staff believes the stipulated increase constitutes a significantly better outcome for customers than what would have been achieved at hearing. This is particularly true when the rate case filing moratorium through June 1, 2011, as specified in the Stipulation is included, effectively shielding customers from further rate increases until at least January of 2012.

Q. Did the parties agree to any account specific revenue requirement reductions?

A. Other than the specific expenses subject to deferral and identified in the Stipulation, the reduction in revenue requirement represents a black box agreement. In other words, the parties did not agree to specific reductions in individual expense accounts or to any particular rationale justifying the adjustment.

Q. What is the implied return on equity (ROE) incorporated in the revenue requirement proposed in the Stipulation?

A. Staff and the Company agreed to an ROE of 10.4% prior to the Company's rate case filing. The agreement between the Company and Staff was documented in a letter dated July 31, 2009, and attached to the testimony of Company witness Doherty as Exhibit No. 6. The agreement on ROE was made between the Company and Staff before the Company case was filed to eliminate ROE as a contested issue in the case, to eliminate the need for an equity return Company witness and to reduce rate case expense.

Q. Why does Staff believe a 10.4% return on equity is reasonable?

A. Staff believes a 10.4% ROE for United Water is reasonable based on ROE previously allowed by this Commission, ongoing capital requirements and current market conditions. The previously authorized ROE for United Water is 10.6% in 2000, Order No. 28505; 10.3% in 2005, Order No. 29838; and 10.3% in 2006, Order No. 30104. Idaho Power Company was authorized a 10.5% ROE on January 30, 2009, Order No. 30722, and PacifiCorp was authorized a 10.25% ROE on April 16, 2009, Order No. 20783. The Commission cited deteriorated economic and financial markets when it approved an increased ROE of 10.5% from 10.25% for Idaho Power Company. Order No. 30722. The increased ROE was found necessary to assure confidence in the financial soundness of the utility, to support credit ratings and enable the utility to raise necessary funds. These same goals are reasonable for United Water and support a 10.4% ROE (an increase from 10.3%).

Q. What does the Stipulation specify with respect to power cost recovery?

A. The Stipulation specifies that United Water's revenue requirement will continue to include annual power expense based on Idaho Power's current base electric rates and the Power Cost Adjustment (PCA) rate that was in place the last time United Water rates were set. PCA power costs incurred above that rate will continue to be deferred through March 1, 2010, and amortized over a three-year period. After that date, all PCA costs will be deferred with a carrying charge (customer deposit rate) for later amortization.

Q. Why did Staff agree to treat power costs in this manner?

A. The Company originally proposed to include the current Idaho Power PCA rate in revenue requirement even though the PCA is scheduled to change on June 1, 2010. Both Staff and Idaho Power Company anticipate a significant decrease in the PCA on that date. Staff did not believe it was appropriate to include a temporarily high PCA rate in the United Water base revenue requirement. In addition, Staff believed it was reasonable given the magnitude of the

United Water rate request and the difficult economic conditions currently experienced by Company customers to continue deferral of extraordinary power expenses for later amortization and recovery. Deferral of these power costs for future amortization removed approximately $500,000 from United Water's revenue requirement request. While Staff supports deferral of PCA costs rather than including them in United Water base rates at this time, Staff continues to believe that these costs are legitimate operating expenses and fully subject to recovery through amortization.

Q. What other costs were specified for deferral in the Stipulation?

A. The Stipulation also allows the Company to defer the costs of: 1) Rate Case Expenses; 2) Tank Painting; and 3) Conservation Plan and Implementation Expense. These costs will be deferred and amortized for ratemaking purposes beginning March 1, 2010. The amortization periods will be: 1) three years for rate case expenses; 2) twenty years for tank painting and rehabilitation of the Ustick, Crestline and Steelhead water storage reservoirs; and 3) three years for the Conservation and Implementation expense. Staff also acknowledged that existing deferrals and amortizations will continue as previously authorized. While Staff generally agrees that expenditures for these items are appropriate, Staff reserves the right to more fully evaluate the actual costs in the future to determine that all deferred costs and amortizations are reasonable and reported properly.

Q. What does the Stipulation specify in terms of rate spread and rate design?

A. The Stipulation specifies no change in rate design and an across the board increase in all existing rate components. For example, if the Commission approves the Stipulation, the bimonthly customer charge for a customer with a ¾ inch meter will increase from $16.21 to $17.82 on March 1, 2010, or approximately 81 cents per month. The winter and summer first block commodity rate will increase from $1.2112 per 100 cubic feet (CCF) to $1.5141 per CCF. The summer second block commodity rate will increase from $1.3317 per CCF to $1.6648 per CCF. On February 1, 2011, these customer charges and winter (including first block summer) and summer (second block only) commodity rates will increase to approximately $18.13 bimonthly, $1.54 and $1.69 per CCF, respectively.

Q. Why did Staff agree to maintain the existing rate structure and support a uniform increase in all rate components including customer charges?

A. Staff agreed to maintain the existing rate design based on Commission Order No. 30865 which waived the requirement for the Company to submit a cost of service study with its rate case application. Staff did not believe it was appropriate to change rate design without a study supporting such a change. Likewise, Staff agreed to a uniform rate spread in this case in part due to a lack of a current cost of service study. Other factors supporting an increase in the customer charge in this case were the increasing cost of fixed charges associated with customer services and as a concession to further reduce revenue requirement specified in the comprehensive settlement.

Q. Why has Staff agreed to the Budget Bill Plan proposed by the Company?

A. Staff has long supported a customer payment plan to allow customers to pay equal monthly payments throughout the year. Other utilities have similar voluntary plans that assist customers in managing high seasonal billings without sacrificing price signals. This is particularly helpful for United Water customers who face high seasonal bimonthly bills. Any additional cost of the program at this time will be borne by the Company within the stipulated revenue requirement. Finally, the Company has agreed to promote use of its E-billing program in conjunction with its budget bill program to further reduce overall billing costs.

Q. Could you please comment on the two remaining provision of the stipulation – Private Fire Line service and the Informal Workshops?

A. Yes. Staff supports the change to United Water's rules and regulations regarding the Company's responsibility for Private Fire Line Service. The language modification proposed by the Company is consistent with rules for other service line connections and will eliminate confusion and costs for the Company and its customers.

Finally, Staff fully supports and plans to participate in informal workshops scheduled by United Water to discuss low income issues such as UW Cares. The workshops will also cover how to improve participation in Company demand side management programs. Staff believes programs that help customers manage their water bills are particularly important at this time and need to be addressed.

Q. Does this conclude your testimony in this proceeding?

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 28TH DAY OF JANUARY 2010, SERVED THE FOREGOING **DIRECT TESTIMONY OF RANDY LOBB IN SUPPORT OF STIPULATION,** IN CASE NO. UWI-W-09-1 BY MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

KEVIN H. DOHERTY
UNITED WATER IDAHO INC
200 OLD HOOK ROAD
HARRINGTON PARK, NJ 07640
E-MAIL: Kevin.doherty@unitedwater.com

DEAN J MILLER
McDEVITT & MILLER LLP
PO BOX 2564
BOISE ID 83701
E-MAIL: joe@mcdevitt-miller.com

BRAD M. PURDY
ATTORNEY AT LAW
2019 N 17TH STREET
BOISE ID 83702
E-MAIL: bmpurdy@hotmail.com

Jo Nelson

SECRETARY