Office of the Secretary
Service Date
October 5, 2015

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE JOINT APPLICATION OF UNITED WATER IDAHO INC. AND THE CITY OF BOISE, IDAHO FOR APPROVAL OF AN AGREEMENT FOR REPLACEMENT AND OPERATION OF FIRE HYDRANTS AND RELATED RATEMAKING TREATMENT	**CASE NO. UWI-W-15-02** **ORDER NO. 33390**

On April 10, 2015, United Water Idaho Inc. ("United Water") and the City of Boise, Idaho ("Boise" or "City," and jointly "Applicants") filed a joint Application seeking Commission approval of their agreement to transfer responsibility for the operation, maintenance, and replacement of fire hydrants located within Boise's municipal boundaries from the City to United Water ("Agreement"). United Water further seeks approval of certain ratemaking treatment to recover the increased costs associated with the transfer. Both Applicants prefiled testimony in support of the Application and Agreement.

On May 12, 2015, the Commission issued a Notice of Application and Notice of Modified Procedure requesting written comments. Comments were filed by Commission Staff and by one customer. Boise and United Water each filed reply comments on August 13, 2015. As set out in greater detail below, we approve the transfer Agreement.

THE JOINT APPLICATION

Boise currently owns and maintains more than 6,700 fire hydrants within the city limits. In July 2014, the Applicants entered into the Agreement to transfer ownership and operation of those hydrants located within the utility's service area to United Water. The Agreement calls for Boise to provide an annual report to United Water of hydrants approaching the end of their 40-year life and thus need replacing. Ownership of the hydrants wi l be transferred when United Water replaces and thereafter maintains those hydrants. The Applicants estimate that approximately 168 hydrants will be replaced annually over the next 40 years, at which point the full transfer of ownership of all eligible hydrants will be completed.

The Applicants list several purposes for the Agreement. More specifically, they claim that it is "generally to provide operations consistent with other communities in the state; to create equity among taxpayers and ratepayers; to make available capital funding for fire protection infrastructure and other essential services; to conform with the intent of the franchise agreement; and to vest ownership of the hydrants with the entity that owns the infrastructure connected to the hydrants with the experience and expertise to maintain them." *Application* at 3.

In addition to approval of the transfer of ownership, United Water seeks approval of two ratemaking measures. First, it requests that the costs associated with the transfer be fully included in rate base (not using a typical 13-month average), and recovered in any subsequent general rate proceedings over the life of the Agreement. Second, the utility seeks Commission approval to continue the calculation and accrual of post-closing "allowance for funds used during construction" (AFUDC) on the hydrant investment until such a time that those investments are fully accounted for and included in rates in a subsequent general rate case. United Water estimates that "the annual revenue requirement associated with the initial capital investment [will be] approximately $765,000." *Id.* According to United Water, this initial cost will increase annual rates by approximately $1.45 per costumer in the first year. *Id.* at 4.

The Agreement provides that each party has the right to declare the Agreement "null and void" should the Commission not approve the Agreement, including the accounting treatment requested by United Water. *Application* Exh. 1 at ¶ 2. The Agreement will become effective 30 days after the Commission issues a final and non-appealable Order. The Applicants intend that the terms of the Agreement be incorporated in a new franchise agreement between the City and United Water. *Id.* at ¶ 6.

THE COMMENTS

The Applicants advanced several reasons in support of their Application. In general, they maintain that the Agreement to transfer the hydrants is in the public interest. As set out below, Commission Staff expressed several concerns about the Agreement. Based upon its review, Staff concluded that the benefits of the transaction were insufficient to justify approval of the Agreement.

There was one public commenter who insisted the transfer of the hydrants does not justify a rate increase. Boise and United Water both filed replies generally maintaining their previous positions, and encouraging the Commission to approve the Agreement.

A. Consistency with Other Communities in the State

The Applicants first assert that approval of the Agreement will create consistency with other communities within the State. They argue that the current arrangement is inconsistent with other Idaho communities because in Boise, the entity that provides the water for fire protection (United Water) does not own the fire hydrants. Rather, in Boise, the hydrants are owned and maintained by the City.

Staff agrees with the Applicants that it is ordinarily the case in Idaho that ownership of hydrants typically resides with the provider of water service. However, Staff points out that in most Idaho communities, it is the municipality that operates/owns the water system and the hydrants. Unlike most Idaho communities however, Boise was, and is, served by regulated water companies such as United Water. Staff maintains that even if the Agreement is approved, Boise will remain unique among Idaho communities because it will not own its fire hydrants *or* water system. Staff concludes that creating consistency is not a significant reason for approval of the Agreement.

In response, the Applicants again emphasize creating consistency with other Idaho communities – where the water provider owns the entire water system, including the hydrants. For clarity, Boise admits that it "would very much like to own and operate the entire water system located within Boise's corporate limits," noting "numerous governance issues and lost opportunities." *Boise Reply* at 4. In spite of that stated desire, Boise's elected officials determined that going forward, ownership and maintenance by United Water "is the most efficient and safe way to provide water service and fire protection." *Id.* at 5.

Commission Findings: We find that creating consistency with other municipalities is, by itself, not a sufficient reason for approval of the Agreement. The City and its water utilities have operated under the current system for decades and achieved a Class III fire rating – the same as would be maintained under United Water ownership.

B. Equity among Water Customers

The Applicants next contend that approval of the Application will improve equity among the various classes of water customers. They note that under the current scheme, the City covers its hydrant expenses from Boise's General Fund which is supported primarily by customer property taxes. They insist that some water customers, including federal and state governments, non-profits, and other tax-exempt entities are exempt from paying property taxes. Because these tax-exempt entities do not pay property taxes, the Applicants assert that an inequity arises between water customers who pay and do not pay property tax. In an effort to remedy this inequity, the Applicants believe it is appropriate to transfer the hydrants to United

Water's ownership so that all water users will then contribute to the hydrant expenses through their utility rates.

Staff raises two concerns with this reasoning. First, Staff is concerned that approval of the Agreement may result in greater inequity between some ratepayers, leaving some United Water customers paying substantially different amounts for hydrants under United Water ownership than under City ownership, regardless of their fire protection needs. For example, Staff compares a hypothetical large office building with relatively low water usage, high property value, and more costly requirements for fire protection, to a hypothetical homeowners' association with lots of landscaping associated with relatively high water usage, but with low property value and little or no requirements for fire protection. *Id.* Staff suggests that a ratepayer needing little fire protection may pay significantly more for hydrants than a ratepayer with greater and more costly fire protection needs. *Id.*

Second, Staff points out that while governments, non-profits, and other tax-exempt entities do not pay property taxes, these entities all pay the 3% franchise fee that is assessed on all United Water customers pursuant to *Idaho Code* § 50-329A. When collected, these franchise fees are deposited into the City's General Fund. Staff asserts that the franchise fees provide ample revenue to the City – more than two and half times greater than the City's annual hydrant budget. Over the past five fiscal years, Boise has collected a total of $5.37 million (an average of $1.075 million per year) in franchise fees from United Water ratepayers. *Id.* at 7. This annual amount exceeds the $450,000 Boise currently budgets for hydrant maintenance and replacement. *Id.* at 4. Staff suggests that a reduction in United Water's franchise fee may be the simplest and easiest way to improve equity for the increase in costs that will be borne by ratepayers if the Agreement is approved.

In response, Applicants continue to stress that the proposed transfer will create more equity among ratepayers. Responding to Staff's hypothetical, Boise dismisses it as an "extreme scenario," and not "probable." *Boise Reply* at 5. United Water admits that "future recovery of hydrant related costs could impact different customers in different ways," but insists that "is not a reason to reject the Agreement." *United Water Reply* at 8. The City also characterized Staff's comments as an impermissible intrusion into Boise's budgeting and expenditure of franchise fees. *Boise Reply* at 5-6.

Commission Findings: The Commission rejects the Applicants' contention that suggesting a reduction in franchise fees "is asking the Commission to rewrite the Code to prohibit the collection of franchise fees paid by the customer when the franchise fees may be used by the City to fund services . . . with which Commission disagrees." *City Reply* at 11. This Commission has no intention of encroaching on the City's use and management of franchise fees collected from United Water customers. However, it is worth noting that there have been prior cases where utilities and municipalities have adjusted franchise fees to accomplish mutual goals. *See* Order No. 29634 at 5. It is certainly true that the City could ameliorate the financial impact of this Agreement on city residents should it choose to do so.

All United Water customers currently share the expense for maintenance of hydrants outside the Boise City limits. Inclusion of Boise City hydrants will simply increase all customers' bills without a corresponding decrease in franchise fees. So, all United Water customers will experience an increase in their water bill and Boise City's United Water customers will still continue to pay a 3% franchise fee. Therefore, we are not persuaded that the Agreement will significantly improve "equity" among water users.

C. Benefits to Ratepayers

According to the Applicants, if the Agreement is approved by the Commission, United Water customers will benefit by having the oversight and maintenance of the hydrants managed by United Water, which has added experience and expertise because of its role in the operation and maintenance of the City's water distribution system. The Applicants contend that having United Water take over responsibility for the hydrants will allow the Company to integrate the operation and maintenance of those hydrants into its tracking systems (GIS & work management), contract preparation and bid processes, and current industry practices and standards to ensure operational efficiency. *United Water Reply* at 7 (citing Wyatt Response to Staff Production Request No. 3). Further, they contend that United Water has better financial, technical, and operational resources to ensure that hydrants are maintained, repaired and/or replaced more quickly without the delay of coordinating those efforts with City personnel. The Applicants conclude that water customers would benefit over time through enhanced overall fire protection system integrity stemming from United Water's expertise, technical and financial resources, and ability to respond promptly to and resolve any potential hydrant issues.

Staff opines that both the City and United Water have sufficient capabilities to properly operate and maintain fire hydrants regardless of the proposed Agreement. Staff points out that even if the Agreement is approved, Boise will continue to maintain responsibility for those hydrants it will own over the projected 40-year transition period, and other hydrants outside of United Water's service area. Further, Staff notes that Boise has maintained a Class III fire rating for over 24 years while maintaining its own hydrants and that the City anticipates that rating to continue regardless of future hydrant ownership.

Commission Findings: We find that United Water will be able to maintain and replace Boise fire hydrants at a more efficient and higher level of expertise. United Water personnel are trained in American Water Works Association procedures and industry best practices for operation and maintenance of fire hydrants. *United Water Reply* at 6.

Furthermore, it is United Water's responsibility to provide sufficient pressure and a supply of water for fire protection. Hydrants are an integral part of the utility's fire protection responsibilities. It is in the public interest to provide adequate and efficient fire protection. Accordingly, approval of the Agreement is a fair and reasonable way to enable United Water to improve efficiency of providing safe and reliable water for fire suppression to Boise residents.

D. Costs to United Water Ratepayers

Applicants state that the annual revenue requirement for transferring the hydrants per customer in the initial year would be approximately $0.24 per bi-monthly bill. *Application* at 4. Staff calculates that this number is a reasonable initial estimate for the first year only. As set out in the Agreement, each year for the next 40 years, United Water will invest an additional $765,000 in the hydrant program. Thus, every year, United Water's revenue requirement will increase in order for the Company to recover a return on rate base, depreciation, O&M expenses, and taxes. As a result, the total annual revenue requirement in the first year is approximately one dollar per customer, but after 40 years, the total annual revenue requirement will increase to more than $26 per customer. *Staff Comments* at 11. These calculations are undisputed. *See United Water Reply* at 4, and *Boise Reply* at 12.

Staff asserts that the cost of owning and maintaining hydrants would be much lower if the City were to retain ownership. As an investor-owned utility, United Water, unlike Boise, is allowed to earn a return on its investment in the hydrants. United Water will also pay taxes on its earnings, further increasing the cost to customers, as well as pay property taxes, while the City is tax-exempt.

Applicants do not dispute that ratepayers will pay for United Water's replacement of the hydrants. However, they continue to insist that the cost is minimal, the gradual transfer allows for a measured impact, and the costs borne out of the sale are fair in exchange for the efficiency of service provided by United Water ownership.

Commission Findings: While we recognize customers will experience an increase in service rates, we find the increase is offset by improved fire protection and efficiencies for City residents. Likewise, in light of all the circumstances, we find that the present and future public interest will be served by allowing the transfer of ownership of fire hydrants to United Water.

E. Ratemaking Issues

As part of the Agreement, United Water requests that the Commission utilize two accounting treatments relating to the transaction. First, that the hydrants be included in rate base at their full investment and not use a 13-month average rate base. United Water reasons that "investments in new and replacement fire hydrants within the City of Boise will not, in and of themselves, generate any new or additional revenue," and that a "customary 13-month averaging methodology could result in the full amount of the investment not being recognized in rates." *Wyatt Direct* at 7. Second, United Water requests that "the Commission allow the Company to continue the calculation and accrual of post-closing [allowance for funds used during construction (AFUDC)] on the investments anticipated by the Agreement until such time as those investments are fully accounted for and included in rates in subsequent general rate case determinations over the life of the Agreement." *Wyatt Direct* at 6.

Staff agrees with the first request that the costs associated with the transfer be fully included in rate base (not 13-month average), and recovered in a subsequent general rate case. Staff opposes the second request for post-closing AFUDC, noting that the filing of rate cases is within the discretion of each utility, and under the circumstances United Water could have included this request in its current general rate case. In response to Staff's comments regarding AFUDC, United Water withdrew its request for post-closing AFUDC accrual. *United Water Reply* at 9.

Commission Findings: Because United Water's investment in new and replacement hydrants within Boise City will not generate new or additional revenue, it is reasonable for

United Water to include the transfer costs in rate base (not 13-month average). In determining the reasonableness of the proposal, we considered the estimated annual revenue requirement ($765,000), and how that amount compounds over the ensuing years. We make no findings regarding the appropriateness of the approved accounting treatment for any other part of United Water's business. In this regard, specific approval of rate making caused by this case shall be considered in subsequent general rate cases.

SUMMARY

Having reviewed the arguments advanced by the Applicants and Staff, and based upon the particular facts of this case, the Commission finds that the Applicants have met their burden of showing that approval of the Agreement is fair, just and reasonable; and transferring responsibility for the operation, maintenance and replacement of fire hydrants to United Water is in the public interest. Over time, United Water customers located within the City will benefit from improved efficiency by having the utility install, maintain and own the fire hydrants. Hydrants are simply part of the utility's fire protection responsibility. These improvements are consistent with the public interest.

ORDER

IT IS HEREBY ORDERED that the Joint Application of United Water and the City of Boise for approval of an Agreement transferring fire hydrant ownership and related ratemaking treatment is granted. Any rate changes resulting from approval of the Agreement shall be addressed in United Water's next general rate case.

THIS IS A FINAL ORDER. Any person interested in the Order may petition for reconsideration within twenty-one (21) days of the service date of this Order with regard to any matter decided in this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 5th day of October 2015.

PAUL KJELLANDER, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

KRISTINE RAPER, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

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