DECISION MEMORANDUM

TO:COMMISSIONER NELSON

COMMISSIONER SMITH

COMMISSIONER HANSEN

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FROM:SCOTT WOODBURY

DATE:AUGUST 5, 1996

RE:CASE NO.  UWI-W-95-2

GARDEN CITY EXCHANGE—RECONSIDERATION

Application

On July 31, 1995, United Water Idaho Inc. (United Water; UWI; Company), a public utility providing domestic water service, filed an Application with the Idaho Public Utilities Commission (Commission) requesting approval of a Service Area Exchange Agreement (Exchange Agreement, Agreement) with the City of Garden City and a related amendment and revision to its Certificate of Convenience and Necessity No. 143, relinquishing a portion of its certificated area.  The Exchange Agreement, dated July 20, 1995, provides for an exchange of service areas between United Water and Garden City whereby the Company agrees to provide service to the “North State Area” and Garden City agrees to provide service to the “Millstream Area.”  The Agreement was proposed by Garden City to comply with mutual promises and agreements set forth in an underlying Memorandum of Understanding (MOU) between Garden City and the City of Boise.  The net effect of the proposed Agreement is that Garden City would provide water service to areas lying within its corporate boundaries and area of impact and would no longer provide water service to areas lying within the Boise city limits and Boise area of impact.

Denial of Application

On March 14, 1996, the Commission issued final Order No. 26367 denying the Company’s Application.

The Commission was not persuaded in its earlier consideration of this matter that the political implications of the exchange for Garden City or the City of Boise should dictate the outcome in the case.  Indeed, as the Commission stated, it appears that the underlying memorandum of understanding between the cities resolve the problem of city and area of impact boundaries and water service competition between Garden City and United Water.

The Commission’s analysis in the earlier proceeding focused on an assessment of the relevant exchange benefits to the North State Area customers, the Millstream customers and the Company’s remaining customers.  The Commission concluded that apart from water pressure problems, which it seemed that both Garden City and United Water were capable of remedying, the exchange agreement failed to offer North State customers the outcome they most desired, a solution to their water quality problems.

Regarding the impact of the proposed exchange on the Company’s existing customers, the Commission in its earlier Order noted “although the Company maintains that its existing customers will not be adversely affected by the exchange, it is clear that the Company is not inclined to absorb any revenue shortfall or calculated subsidy requirement based on exchange-related costs.”  The Commission found that many questions remained unanswered in the Company’s case such as an actual verified number of customers in the North State Area, total exchange agreement costs including acquisition price, a reasonable estimate of other foreseeable exchange-related costs and direct and indirect expenses.  The Commission rejected the Company’s suggestion that it would be proper for the Commission to approve the exchange in principal and wait for the details.  We cannot do so, the Commission stated, and fulfill our statutory obligations.  Despite a recitation of reasons for approval, the Commission found that the Company had failed to demonstrate that the exchange was in the public interest or would benefit either the Company, the affected customers or the Company’s existing customers.  Any subsequent proposal to the Commission to achieve the desired realignment, the Commission stated, must provide benefits to the affected customers in the North State Area as part of the exchange and should not negatively affect existing customers.

Petitions for Reconsideration

On April 4, 1996, both United Water and Garden City filed Petitions for Reconsideration.  United Water requested the opportunity to present additional and more detailed evidence regarding water quality and water pressure, the actual number of customers in the North State Area, benefit/cost analysis, and accounting treatment of the purchase price.  Garden City requested the opportunity to supplement the record with evidence regarding customer numbers (actual and projected), water quality and water pressure, operational and service problems, duplication of infrastructure, opportunities for public input and cost/benefit analysis.

On April 11, 1996, the participating Homeowner Associations filed a letter response to the Petitions for Reconsideration.  In their letter, the North State Area customers pointed out that neither United Water nor Garden City proposed any more than additional studies to address water quality and water pressure concerns.  No immediate fix of water quality, they noted, was being proposed.  Additionally, the Associations noted that neither petitioner chose to address ways to mitigate the “rate shock” associated with the proposed exchange.  Finally, the Associations noted that still no direct effort had been made by Garden City, United Water or Boise City to communicate with affected customers.  The Associations expressed a desire to remain involved in the process but indicated the short seven day window of response did not permit the Associations the opportunity to notice and poll their members and submit a more formal response.

Reconsideration Granted

In its Order No. 26437 issued May 1, 1996, a split Commission granted reconsideration, finding as follows:

The Commission has reviewed the filings of record, transcript and final Order No. 26367 in Case No. UWI-W-95-2.  The Commission has also reviewed and considered the related petitions for reconsideration.  The Commission finds that its prior Order is supported by the hearing record and is otherwise reasonable.  Indeed neither petitioning party suggests that the Commission’s Order is unreasonable, unlawful or erroneous or unsupported by the record.  Reference Idaho Code § 61-626; Commission Rules of Procedure IDAPA 31.01.01.331.01.

What the petitioners in this case have requested is that they be permitted to open the record and submit further and more detailed testimony and evidence that the exchange is in the public interest and will benefit the affected customers in the North State Area, and will not adversely affect the Company’s existing customers.  We are disappointed that United Water failed to present its full case in the prior proceedings.  We have already expressed our disappointment at Garden City’s failure to participate in the earlier proceedings.  Despite our concern we note that the affected customers in this case who are most inconvenienced have still not been included in this process by either the Company or the City.  We reluctantly reopen the record in this case to permit further testimony and evidence.  We do so because it procedurally provides a speedy and expeditious means for record augmentation, review and reconsideration.  Reference IDAPA 31.01.01.013.

We trust that the petitioners are not prematurely bringing this matter back before this Commission and are prepared to now present persuasive reasons for approving the exchange of service territories.  We expect that the petitioners will present the results of further analysis and reasonable and near term resolutions to the identified water quality and water pressure problems.  This Commission does not question the underlying reasonableness and rationale behind the proposed exchange, only the timing and the rate impacts on customers.  The North State area customers cannot be asked to wait two to ten years for a technical fix to water quality problems while being asked to pay higher rates immediately.  United Water must demonstrate an ability to deliver improved water quality and pressure to North State area customers in order to justify the exchange and the associated increase in rates to the North State area customers.  We provide the petitioners the latitude to present an amended Exchange Agreement to the extent that an amendment will make the exchange more acceptable to customers and this Commission.  We apprise the petitioners that if the Agreement and facts are otherwise the same as previously presented, then there is no reason to expect a different result.

Hearing on Reconsideration

Public hearing on reconsideration in Case No. UWI-W-95-2 was held in Boise, Idaho on June 27, 1996.  The following parties appeared and participated by and through their respective counsel:

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| United Water Idaho, Inc.  Garden City  Neighborhood Associations  Coventry Neighborhood Association  Gary Lane Meadows Homeowners Association  Pierce Park Meadows Homeowners Association  Commission Staff | Kenneth G.  Bergquist  Jack Britton  Barton L. Kline  Scott D.  Woodbury |

Public testimony was taken in an evening hearing on the same date.

Amended Exchange Agreement

United Water and Garden City on reconsideration and rehearing present the Commission with a number of proposed changes to the underlying Exchange Agreement.  The changes to which the parties have ostensibly agreed (Tr. pp. 386-387) can be summarized as follows:

∙Number of customers—reduced customer count in North State Area from 912 to 872.  (Tr. p. 434).

One-hundred fifteen additional services have been installed and are awaiting hookup or construction.  Tr. pp. 434, 475, 476.

∙Cash purchase price—reduced from $593,250 to $541,800 to reflect reduced customer count.

∙Immediate inter-tie to UWI distribution system.

—to enhance and stabilize pressure.

∙Water supply for North State Area

—purchase price for GC water for peak period (May-September) reduced from 45¢/1,000 gallon to 35¢/1,000 gallon.  (Tr. pp.  461-462)

—off peak (October-April)—to be served by existing UWI facilities.

—peak (May-September)—UWI will augment supply with GC water.

GC will construction an additional pumping/regulating facility within 60 days. Tr. pp. 429, 444.

An additional element of change on rehearing is the Company’s rate phase-in proposal for North State customers.  Tr. pp. 387-389.  The rate phase-in is to follow water pressure improvement and would be structured as follows:

Phase 1—existing GC rates until intertie is completed (approximately three-six months).  Tr. p. 402.

Phase 2—85% of now existing UWI rates              12 months.

Phase 3—92% of now existing UWI rates              12 months

Phase 4—transition to full UWI rates.

Garden City

Garden City identified on rehearing a number of problems associated with the operation of a municipal water system outside of corporate boundaries, e.g., municipal ordinance enforcement, identification of service provider, fire hydrants (performance, ownership and maintenance).  Tr. pp. 436-438.  Garden City further related that the physical configuration of the water system in the North State Area presents difficulties in providing adequate sustained water pressure to North State Area customers and has inhibited its ability to address those customers’ water quality concerns.  Tr. pp. 438, 439.

United Water, Garden City concedes, has capabilities that Garden City does not possess to provide the product that the customers desire.  Tr. p. 440.  The City relates that it has no immediate plans (or money) to move forward with storage facilities or central control systems of its own.  The City further has no conservation or regular flushing program.  Tr. pp. 441-442.  Garden City relates, however, that its physical plant is not deficient as Staff suggests but merely presents hydraulic challenges and source water quality problems.  Tr. p. 457.

United Water contends that approval of the Exchange Agreement will facilitate planned orderly growth.  Tr. pp. 455-456.  The City informs the Commission that planning decisions are being deferred pending the Commission’s decision and recommends that the Commission lend greater weight to the desires of the elected representatives of both Garden City and Boise City.  Tr. p. 457.

Water Pressure

As in the previous hearing, it is generally agreed that interconnection of the North State Area facilities with UWI distribution and reservoir facilities will increase and stabilize water pressure.  UWI Tr pp. 359-360, GC Tr. 442-444, 463, Staff Tr. pp. 491, 492.  Although United Water appears to hedge its bets by stating elsewhere that water pressure “should not be negatively affected by moving away from Garden City Water.”  Tr. p. 380.

If the exchange is approved United Water would immediately put in place pressure recorders to monitor pressure before and after the intertie, would install SCADA equipment and proceed with a flushing program.  Tr. p. 523.

Water Quality

The water quality problems experienced in the North State Area are aesthetic in nature and consist of high levels of iron and manganese.  The problem is seemingly not ubiquitous, however, as many customers testified that their water quality was fine.  Garden City’s attempts to treat the problem with sequestering has been impeded by the physical configuration of the system and system limitations.  Tr. pp. 446-448.

Garden City represents that North State Area customers will be provided with immediate improvement of water quality during the seven-month off-peak season (October-April) by using United Water’s existing sources of higher quality waters.  Tr. pp. 463-465.  United Water is seemingly more guarded in its expectations stating that it is “reasonable to anticipate that their water quality may improve during this ‘off-peak’ period.”  Tr. pp. 361, 413.  By combining UWI’s waters with Garden City waters during the peak season (May-September) the problem waters of Garden City are diluted.  Tr. pp. 492, 493.  Neither Garden City nor United Water have proposed a method to monitor water quality after interconnect to determine if it has improved and by how much.  Tr. p. 493.

Although United Water has stated its intention to improve water quality year round, it admits that it will be much more difficult, will require extensive analysis and may be very expensive.  Possible solutions include sequesterants, filtration, pumping water from the west bench, aquifer storage and recovery, and biological treatment.  The Company hopes to have a pilot program in operation within the next two years.  Tr. pp. 361-363, 372-376.  The nature, location and extent of the pilot program has not been determined.  Tr. p. 493.

Although the new proposal increases the potential for water quality improvement, Staff contends that the benefits derived from the exchange do not justify the payment made to Garden City or the subsidy that will be required by United Water customers.  Tr. p. 495.

Financial Considerations of the Agreement

United Water has approximately 50,000 customers and is experiencing 3% growth per year or approximately 1,500 customers.  Tr. p. 504.  The Company’s rate base as stated in its current rate Application is $74,591,966.  The Garden City exchange if approved would increase rate base a little more than 1%.  Tr. p. 518.

United Water estimates (Exhibit 5) that in addition to the $541,800 cash purchase price the Company will also incur the following additional costs for which it requests rate base treatment:

Interconnection cost—$47,500

Metering cost—$31,169 (plus new hook-ups)

Staff contends that an additional cost of the exchange is the Company’s net investment of $104,181 in Millstream facilities.  Tr. p. 396.  If drilled, it was also earlier projected by United Water that a well to serve North State customers would cost an estimated $300,000.  Tr. p. 370.  The Company has yet to settle on a method for providing additional capacity, contending that a well may not be needed.  The ultimate cost, if any, is therefore unknown.  Tr. p. 417.  The Company is also unable to provide estimates for the cost of improving the water quality.  Tr. pp. 370, 371, 512.

Because the North State Area facilities were in large part contributed and because no records exist to permit a different allocation, Staff contends that the purchase price is an acquisition premium that should not be allowed in rate base, since no quantifiable benefit for this premium has been demonstrated.  Tr. pp. 393, 394, 509.  Nor Staff contends should ratepayers be required to fund needed system improvements to water quality or pressure that will probably come only with an additional price tag.  Tr. pp. 490, 509, 510.

Staff calculates that with the proposed known changes existing UWI customers will subsidize the North State Area by as much as $63,000 per year if the acquisition adjustment is allowed in rate base.  Including the cost of a new well will add approximately $30,000 per year to the revenue requirement.  Tr. p. 511, Exhibit 108.  Staff also contends that of current revenue generated by 382 Millstream customers approximately 38% covers incremental costs of service, with the remaining available for general overhead expense.  Tr. pp. 507, 514.  The Company calculating differently contends that proposed revenue is essentially equal to required revenues and that no subsidizing will be required.  Tr. pp. 395, 396, 398, Exh. 5.

Staff contends that the North State Area system should be accounted for in a manner that would allow all rate base, revenues and expenses, including allocated expenses, to be analyzed in a rate case.  This could be accomplished, Staff states, by using separate subaccounts.  Tr. pp. 506, 512, 513.  Regarding separate subaccounts, the Company contends that it is not necessary to keep separate books and records.  The Company maintains that it will be able to provide information with respect to these subsystems within the context of its current accounting practices.

Staff also proposes that if North State Area does not earn sufficient revenue to cover its revenue requirement that the Company’s existing customers be held harmless.  Tr. p. 513.  United Water on rehearing agrees to hold its existing UWI customers harmless.  Such customers, it assures the Commission, will not be asked to subsidize its investment in the Garden City exchange.  Tr. pp. 403, 404, 407.

Rate Phase-In

In the earlier proceedings United Water proposed an immediate transition to United Water rates for North State customers.  The Neighborhood Associations argued that unless United Water could offer a definite improvement in water quality, the customers would receive no benefit from the rate increase and recommended that the Commission reject the exchange.  The Neighborhood Associations also recommended, should the Commission approve the exchange, that rate increases be phased-in and tied to service quality improvement.

On rehearing, the Company proposed a two year gradual transition to full United Water rates following the tie-in to UWI facilities and the expected water pressure improvement that will occur as a result of the tie-in.  Tr. pp. 387-389.  Garden City represents that it lowered the cost of its water during peak season to allow the Company to propose the phase-in.  Tr. pp. 461, 462.

United Water represents that water pressure improvement is a relatively objective straight forward measurement and better basis for phased-in rates than water quality which tends to be more subjective and presents greater difficulty in quantifying the degree of improvement.  Tr. pp. 365, 378.

The Staff does not support a phase-in of rates contending that it will only increase the revenue deficiency and subsidy required from existing customers.  Tr. pp. 487, 494.

Commission Decision

∙re: North State Area

number of customers

Not all customers experience problems with water quality/water pressure

∙re: water quality

Immediate inter-tie (flushing, reservoir, etc)

off-peak —UWI waters

On-peak—augmented with Garden City waters

UWI will continue to assess water quality problem—pilot program in two years.

∙re: water pressure

Immediate inter-tie (booster pumps; reservoir)

∙re: value of the UWI “package” to North State customers—conservation programs, testing, etc.

∙re: cost of exchange

purchase price (cash)$541,800   872 customers (North State Area)

interconnection cost $ 47,500

metering cost$ 31,169

Millstream Exchange$104,181

cost of providing additional capacity (if any)—unknown

cost of improving water quality—unknown

loss of 382 Millstream area customers

(contribution to general overhead)

∙re: aquisition premium

—rate base

—demonstrated benefits

∙re:  rate phase-in

∙re: effect of hold-harmless commitment

∙re:  accounting method

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