

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF THE APPLICATION OF)
UNITED WATER IDAHO INC. FOR) CASE NO. UWI-W-97-6
AUTHORITY TO REVISE AND INCREASE)
RATES CHARGED FOR WATER SERVICE.) ERRATUM NOTICE
_____)**

On July 6, 1998, IPUC Order No. 27617 was issued by this Commission. The following change(s) should be made to that Order:

Page 54, Order Section, paragraph 3

READS:

“IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of \$6,955 and to Ms. Sharon Ullman in the amount of \$4,696.82. United Water Idaho Inc. is directed to pay the intervenors within twenty-eight (28) days from the date of this Order.”

SHOULD READ:

“IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of \$6,955 and to Ms. Sharon Ullman in the amount of \$3,416.22. United Water Idaho Inc. is directed to pay the intervenors within twenty-eight (28) days from the date of this Order.”

DATED at Boise, Idaho, this 10th day of July 1998.



Myrna J. Walters - Commission Secretary

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF)
UNITED WATER IDAHO INC. FOR) **CASE NO. UWI-W-97-6**
AUTHORITY TO REVISE AND INCREASE)
RATES AND CHARGES FOR WATER)
SERVICE.) **ORDER NO. 27617**
)
)
)

SYNOPSIS

This is a final Order in Case No. UWI-W-97-6 determining the revenue requirement and setting interim rates for United Water Idaho Inc. (United Water; Company). By this Order, the Idaho Public Utilities Commission (Commission) authorizes United Water to increase its revenues by \$1,581,989 or approximately 7.15%.

SUMMARY

On November 3, 1997, United Water filed an Application with the Commission for authority to increase its rates and charges for water service. At hearing, the Company reduced its requested revenue increase from \$3,424,516 (15.47%) to \$3,134,039, (14.27%).

Also at issue in this case pursuant to Commission direction are the identified service and water quality issues raised in the filings and submitted investigative reports in Case No. UWI-W-96-6 (In the Matter of the Investigation of United Water Idaho Inc and its Ability to Provide Adequate Service and Water Quality). The identified water quality problem addressed in Case No. UWI-W-96-6 was the presence of iron and/or manganese in United Water's ground water wells at levels exceeding the secondary maximum contaminant levels (SMCLs) listed in the federal Safe Drinking Water Act (SDWA). Although secondary contaminants are classified as non-health threatening, the presence of high levels of iron and manganese can result in aesthetic problems including foul odor, poor taste and discoloration.

United Water serves approximately 57,350 customers in the city of Boise and surrounding areas. The Company's sources of supply consist of the Marden Water Treatment Plant, 71 deep wells and 29 reservoirs with storage capacity of 27.4 million gallons. The combined production capacity of all wells and the treatment plant is approximately 82 million gallons per day.

United Water states that it seeks additional revenues to recover increased operating expenses and costs associated with plant additions, and to produce a fair rate of return. The Company contends that the proposed changes in its rates and charges are just and reasonable and are necessary for the Company to continue to provide adequate and reliable service to its customers.

Pursuant to Order No. 27229 issued November 20, 1997, the proposed schedule of rates and charges in Case No. UWI-W-97-6 was suspended for a period of thirty (30) days plus five (5) months from the adjusted proposed effective date of December 14, 1997. Upon a finding of good cause the suspension period was extended by the Commission in Order No. 27556 until July 1, 1998, and further extended until July 6, 1998, by Order No. 27609. Reference *Idaho Code* § 61-622.

Public hearing in this case was held in Boise, Idaho on April 22-24, 1998. The following parties appeared individually and/or by and through their respective counsel or representative:

| | |
|--------------------------|--|
| United Water Idaho Inc. | Dean J. Miller, Esq. Walton F. Hill, Esq. |
| Idaho Citizens Coalition | Al Fothergill |
| Sharon Ullman | Pro Se |
| Commission Staff | Scott D. Woodbury, Esq. |

The Coalition of United Water Customers, Eagle Water Company, Hidden Springs Community, LLC and Hidden Springs Water Co., although previously granted intervenor status, neither participated in nor appeared at the hearing.

At hearing, United Water proposed a rate base of \$84,144,467, a reduction of \$56,274 from the rate base of \$84,200,741 contained in its original Application. By this Order, we make the following adjustments to that proposed rate base: (1) elimination of United Water's investment in the Northwest Pipeline,* (2) elimination of a portion of the Company's investment in Island Woods, (3) elimination of a portion of the Company's investment in Redwood Creek/Floating Feather,* and (4) elimination of the Company's investment in the Boise River Diversion project.* We approve a rate base for United Water of \$80,424,286.

*United Water is allowed to begin amortization of these investments with the amortization expense included in the revenue requirement. Discussed more fully later in this Order.

We also make numerous adjustments to the Company's proposed operating results as explained below.

We adopt a return on equity for United Water of 10.75% and an overall rate of return of 9.12%. This yields a revenue deficiency of \$1,581,989, which pending conclusion of the cost of service/rate design phase of the Company's rate case, we allocate by a uniform percentage increase in rates and charges for all customers. Water usage on and after July 1, 1998 will be billed at the rates approved in this Order.

By this Order we also award Intervenor Funding to the Idaho Citizens Coalition in the amount of \$6,955 and to Ms. Sharon Ullman in the amount of \$3,416.22.

The Commission has reviewed the filings of record in Case No. UWI-W-97-6 including the transcript of proceedings, exhibits and post-hearing briefs. The Commission has also reviewed its Orders in Case No. EUW-W-94-1 (Eagle Area Certificate Case), UWI-W-95-2 (Garden City Exchange) and other Orders specifically referenced herein.

FINDINGS

I. Test Year

United Water proposes a historical test year ending June 30, 1997 with operating adjustments to both rate base and operating results for post test year changes. Staff and Intervenor object to some of the adjustments but no party objected to the proposed test year.

We find:

The use of a historical test year ending June 30, 1997 is reasonable for the purposes of this rate case.

II. Rate Base

United Water in its Application proposed an adjusted rate base of \$84,200,741. Reference Exhibit 4, Schedule 1, p. 2. As set forth in Company rebuttal Exhibit 20, the Company proposes a restated rate base of \$84,144,467. Tr. p. 1000.

The Company has agreed to and incorporated the following Staff proposed adjustments in its rebuttal rate base calculation:

- Eliminate equity gross-up AFUDC (\$54,753)
- Retire Data Point computer equipment (\$ 5,021)

Undisputed acquisition projects proposed for rate base treatment are \$137,600 for the Company's Banbury Subdivision, and \$576,740 for the Warm Springs Mesa.

Also undisputed as now being "used and useful", is the proposed rate basing of the Pierce Park/Gary Lane main installation in the amount of \$252,937. This project was previously disallowed in Case Nos. BOI-W-93-1 (Order No. 25062) and BOI-W-93-3 (Order No. 25640). Tr. pp. 43-48. Expressing concern with the costs the Company was incurring in its competition with Garden City, the Commission previously ordered the Company to enter into special facilities contracts as a way of financing line extensions. The Company did not do so and now states that it became apparent following the Commission's Order that it would be impossible to fulfil the Commission's requirement as developers would seek to obtain service from Garden City rather than enter into such an agreement. Tr. pp. 44, 45. The Pierce Park main, the Company states, has now become a vital link to provide adequate service to a major service area. In 1995 the main was connected to the Hidden Hollow Reservoir in Seaman's Gulch which provides water storage for fire protection and peak demand. The main now provides direct benefit, the Company states, to approximately 5,000 customers, to customers added west of Gary Lane, to customers between Gary Lane and Pierce Park and to all customers in the west main service zone. Tr. pp. 46, 47. The Company notes that as a result of its investment not being included previously in rate base, it has already forgone approximately \$190,000 of revenue. Tr. p. 48.

We find:

This is the third attempt by the Company to rate base its Pierce Park investment. Recognizing the system benefits now flowing from the Company's investment, the Commission agrees that it is now reasonable to allow a rate base addition in the requested amount, \$252,937. In our prior decisions denying rate base treatment, we sought to protect the Company's customers from the then adverse and uneconomic consequences related to the Company's competition with Garden City. Those concerns have been addressed with the North State acquisition.

The following proposed adjustments in Case No. UWI-W-97-6 remain disputed:

| | Amt. incl. in UWI request | Proposed Adjustment |
|--|------------------------------|------------------------|
| • North State acquisition adjustment | \$577,664 | (\$577,664) |
| • Northwest Pipeline | \$940,000 | (\$940,000) |
| • Island Woods | \$260,751 | (\$ 73,400) |
| • Redwood Creek/Floating Feather | \$890,269 | (\$824,250) |
| • Three years capitalized corporate overhead | \$787,735 | (\$787,735) |
| • Boise River diversion (Intervenors) | \$1,882,531 | (\$1,882,531) |
| • Book value one vehicle (Co Rebuttal) | \$3,500 | |
| • Transp. adj. for leased vehicles (Incl. Co. Reb. Adj.) | | (\$ 12,505) |

North State Acquisition Adjustment

The facility and customer exchange between Garden City and United Water was approved in Case No. UWI-W-95-2. The incremental increase in rate base requested in this case to reflect that transaction is the \$673,530 depreciated investment paid for the North State Area less the \$95,966 exchanged Millstream facilities already in rate base. Tr. p. 614. The exchange of service areas was a discretionary decision made by the Company and municipal authorities. Tr. p. 517. In the exchange case Staff recommended that none of the Company's investment in Garden City facilities be allowed in rate base because the purchased plant was previously contributed, i.e., the assets were originally contributed to public service by developers and/or customers. In this case, Staff maintains its opposition to rate base treatment. Tr. pp. 516, 613. If the Garden City system had been owned by another public utility, as was Warm Springs Mesa, the transfer, Staff contends, would have been subject to the accounting instructions contained in the Uniform System of Accounts (USOA) adopted by the Commission. The USOA requires that assets be recorded at the original cost when first devoted to public service, that accumulated depreciation at the date of transfer also be recorded, and that any excess costs be recorded as an acquisition adjustment on the books of the purchasing utility. Inclusion of the acquisition adjustment in rate base would usually be based upon an analysis of the effect on customers. Despite the fact that the selling entity is a municipality, Staff contends that this basic principal should be adhered to. Tr. pp. 517, 518. Assessing the consequences of the exchange, Staff concludes that inclusion of the adjustment cannot be justified. Tr. pp. 518, 519. Before the exchange, the Company had 382 Millstream customers supporting a net rate base of \$95,000; after the exchange they had 898 customers supporting a rate base of \$673,530. Tr. pp. 966, 967.

United Water notes that in Case No. UWI-W-95-2 the Commission Staff made the same arguments for denial of rate base treatment. In that case, it states, the Company was directed by the Commission to make a calculation in its next general rate filing to show how the revenue would support the investment. The Company now argues that if the Commission's intent was to disallow the investment it could and should have done so in that case. Had the Commission done so, the Company states, it would have terminated the trade. Tr. p. 870.

Staff, utilizing a developed investment model, Exhibit 105, contends that North State revenue supports a Company investment in the Garden City exchange area of \$583,164. Staff

Exhibit 105 uses a customer count of 516, the 898 North State Area customers utilized by Company witness Gradilone in determining test year revenue (Exhibit No. 8, Schedule 3, pp. 29-30) minus the 382 Millstream customers given up by United Water in the exchange. Staff contends that North State revenues support very little expense or investment for the water supply needed to serve the North State area (estimated 1 MGD peak demand—Tr. p. 615). Tr. pp. 614, 676, 871. In Case No. UWI-W-95-2 the Company indicated that supply for the North State area would be met in part by purchase of water from Garden City. Exhibit 106. The purchase of water from Garden City required an interconnection investment of approximately \$52,000 and is at a contract rate for all purchased water of 35¢ per 1,000 gallons. The annual revenue requirement associated with water purchases for the North State Area, Staff calculates, would support a water supply capital investment of approximately \$187,000. Tr. pp. 616, 617, 801.

United Water contends that proper analysis demonstrates that North State revenue supports the exchange and any related additional investment. Tr. pp. 869, 870. The Company contends that Staff used the wrong customer count. The Company contends that additional customers have been added to the number acquired bringing the customer count to 927, calculating a total revenue supported investment of \$1,568,000.

We find:

In our Order approving the underlying exchange of service areas in Case No. UWI-W-95-2, a majority of the Commission was persuaded that the exchange was in the public interest and made sense from a system and engineering planning perspective. We believed that the realignment of service areas with municipal and area of impact boundaries would serve to eliminate a disturbing pattern of checkerboard growth and uneconomic investment. Our approval also gave effect to the stated desires of the elected representatives of both Garden City and Boise City. Order No. 26562.

In its underlying Application in Case No. UWI-W-95-2, United Water in its prayer for relief requested that the Commission authorize it to include in its rate base the consideration paid to Garden City under the exchange agreement. In our Order ultimately approving the exchange, we specifically stated “United Water has failed to convince us however that we should preapprove the amount of the purchase price for rate base purposes outside of a general rate case. The Company has the burden of demonstrating the prudence of its investment in these facilities when it seeks to

include them in rate base.” We also noted United Water’s “commitment to hold harmless the Company’s other customers, both from the consequence of the rates and from the exchange transaction as a whole.” Order No. 26562. Our position regarding rate base treatment was reiterated in our denial of the Company’s subsequent Petition for Clarification. Order No. 26646.

United Water now states that the spirit of our prior Orders provided it with some assurance of rate base treatment and that if the Commission was inclined to deny it such treatment it should have done so then. We caution the Company that it acts at its own peril in attempting to read into a specific denial of requested relief, some assurance of future acceptance.

Staff recommends that we consider the entirety of the Company’s purchase investment in the North State Area facilities to be an acquisition premium and deny rate base treatment of same. The record in this case and the related acquisition case clearly support a finding that the facilities transferred to United Water were originally contributed to Garden City rather than purchased. It therefore follows that the purchase price paid by United Water was at a cost which was in excess of the original cost of the property when first devoted to the public service, less applicable accrued depreciation. It is therefore, reasonable to regard the Company’s purchase price as an acquisition adjustment. The Company recommends rate base treatment of its investment, yet as we noted in the acquisition case, the Company acknowledges that its proposal is contrary to established regulatory policy. Order No. 26646.

As a regulatory rule or policy, the position advanced by Staff in this case regarding presumption of contributed capital and accounting treatment is generally accepted. We find, however, that it is also the starting point from which we entertain arguments for exception or different treatment. Each acquisition is reviewed on its own merit. Analysis of the acquisition cost regarding rate base treatment permits an assessment by this Commission of the benefits flowing from the transaction and the impact on the Company’s other customers. An acquisition adjustment is one of several incentive mechanisms that this Commission can use to encourage water industry restructuring. In addition to the stated public policy benefits announced in our approval of the acquisition, we find that the acquisition brings efficiencies of service and improved operations, management and technological expertise to the North State customers. We also find in reviewing the cases related to the phase-in of rates for the North State area that the exchange and related facility improvements have enhanced water pressure and water quality for North State customers. We find

that the transaction provides both present and future benefit to affected customers, municipal planning authorities, and United Water itself. Based on our review of the record in this case and the underlying certificate case, we find it reasonable to conclude that the price ultimately paid by United Water to Garden City was the result of arms length negotiation and was a fair and reasonable price. We are satisfied that the revenue generated by the North State customers supports the exchange and related investment. For all these stated reasons, we find it reasonable to look beyond the contributed nature of the acquired facilities and approve an increase in rate base in the amount of \$577,664 for the North State Area investment.

Northwest Pipeline

United Water calculates that the main service level, which includes the downtown Boise area and the area northwest of the downtown area, has a supply capacity deficiency of six (6) million gallons per day (MGD), a deficiency that requires new water supply facilities. Exhibit 17. To reduce this deficiency, the Company has constructed a 3.5 mile pipeline at a cost of \$940,000 to connect the Hidden Hollow storage reservoir in Seaman's Gulch with the Floating Feather/Redwood Creek water system west of Eagle, a system with a present supply surplus of 2-3 million gallons per day. Tr. pp. 41, 617. Test well drilling in 1997 to locate a new water supply in the State Street Area resulted in the discovery that both the water quantity and quality necessary to serve customers in the main service level was not available. This lack of supply, the Company states, hampered its ability in the summer and fall of 1997 to fill its Hidden Hollow reservoir. To prevent further service-related problems, the Company stated it was faced with the necessity of locating, developing and delivering water to the Hidden Hollow reservoir before peak usage in 1998. To avoid further unsuccessful attempts at locating a supply, the Company decided to tap into a source of known quantity and quality. Tr. p. 41.

Staff contends that the constructed pipeline was not needed, that there was no urgency, that the supply deficiency was no greater in 1997 than in past years (Exhibit 107; Tr. p. 618); that with a planned 8 MGD Marden treatment plant expansion scheduled to come on line in May 1999, the deficiency is short term (Tr. pp. 630, 826-828); that the Company failed to utilize during 1997 peak requirements other supply resources available to it: e.g., the Swift No. 1, which the Company was not using because of aesthetic water quality problems, (Tr. p. 813); Garden City contract supply rights (Tr. pp. 819-824); and available supply from other service levels (Tr. p. 621). In addition, Staff notes that other main service level wells completed since 1997 have been brought on line and are now available—27th Street Well, Tr. pp. 653, 819; also Swift No. 3. Supplies less costly than the pipeline, Staff contends, could also have been constructed (the Company previously estimated that new supply could be developed for approximately \$300,000/MGD—Tr. pp. 617, 654). Staff questioned the Company about parallels between the Southeast Boise Water Supply Project pipeline, which the Company now contends was developed as a temporary water supply, and the northwest pipeline. Staff notes that current and future development and related water supply contracts in the Eagle area may require the Redwood Creek/Floating Feather water supplies (Tr. pp. 618, 619). Staff

also queried why the Company would not have considered bridging what Staff perceives to be a short-term supply deficit with conservation measures, i.e., alternate day sprinkling. Tr. pp. 809, 810, 959, 960-962. Finally, Staff notes that a lengthy distribution pipeline constructed ahead of development places a substantial portion of the cost of new development on the backs of existing ratepayers rather than through developer contributions, as the line extension rules would otherwise require. Tr. pp. 620, 678, 679.

Coincident to the need for new supply in the main service level, Staff notes, construction of the northwest pipeline will make nearly \$850,000 worth of investment in the Eagle area used and useful, will provide reservoir back up and emergency fire protection to the Eagle municipal water system and will make lower cost service available to a large undeveloped area that would simply not be possible without the pipeline. However, none of these reasons, Staff states, should be regarded as justification for making existing customers pay for the pipeline project through rates. Tr. p. 622.

The Company does not agree with Staff's contention that the supply capacity deficiency is short term. Tr. pp. 959-960. It is not unreasonable, the Company contends, to have a system supply capability greater than demand. The nature of the beast, it states, is that wells are mechanical and there are going to be times when they are out of service. Tr. p. 960. It is also not unreasonable, the Company admits, to ask customers to conserve water—indeed, it did that in 1994. Tr. p. 961. United Water by way of rebuttal introduced Exhibit 31 to show supply and design constraints in the United Water system. Tr. pp. 841-846. One critical area of constraint the Company contends is Collister Road west to Horseshoe Bend Road and between State Street and Hill Road. Tr. p. 843. Prior to construction of the northwest pipeline, the Company states there were limitations on the ability of the distribution system to transmit water adequately to the Hidden Hollow Reservoir. Tr. p. 844. The import-export capability of the distribution system, the ability to move water from one pressure level to another, is also limited, the Company states, to 6 - 7 million gallons per day. Tr. p. 846. The Company questions, because of distribution losses, whether the Marden expansion will be able to beneficially impact identified main service level areas of need. Tr. p. 845. The Company disputes any obligation to provide the City of Eagle with any waters other than fire flow. Tr. pp. 962-964.

The Company contends that Swift Well No. 1 should not have been listed by the Company in response to a Staff production request as a source of supply in the main service level

west of 36th Street. It should instead have been noted that it was to be held in reserve for emergency conditions, i.e., when the Company would otherwise be faced with restricting or curtailing water usage. Tr. pp. 813, 814. The Company presently plans to use Swift No. 1 as an aquifer storage and recovery (ASR) project, injecting high quality water into the aquifer and pumping it out during demand periods. It expects the ASR project to be fully operational by summer year 2000. Tr. p. 817.

We find:

The Company has failed to persuasively demonstrate that its decision to construct a pipeline was for its customers a prudent decision, that it was the best economic and planning alternative available to it or that it was even needed at this time. It is undisputed that by completing the pipeline the Company is able to transport surplus water from the Eagle area to Hidden Hollow Reservoir; that its ability to do so provides it with an additional resource to reduce or mitigate capacity deficiencies in the main service level; that it provides a benefit to customers outside the Eagle area; and that it is otherwise "used and useful." It is also undisputed that the Floating Feather well waters will provide the Company with a supply of high quality water for its main service level, water without elevated levels of iron and/or manganese.

Despite the foregoing findings, our decision in this matter is directed by the Company's failure to avail itself of what we find to be other, more economic alternatives. We refer of course to the Company's decision to forego contractual rights in its Garden City supply contract; to forego the use during critical periods of peak demand of its Swift No. 1 well; to ignore the additional main service level well capacity brought on line since 1997, capacity additions which most certainly had to have been planned; to forego the full utilization of water transport capability between service levels; to fully recognize that the main service level supply deficiency would be mitigated to a large degree by the planned 1999 Marden expansion; to forego the planned use of demand conservation measures (e.g., alternate day sprinkling) to bridge what can be reasonably perceived to be a short-term supply deficiency.

Although the Commission will not allow the investment to be rate based at this time, we will allow the Company to recover amortization of its investment in recognition that it is used. Embedded in the Company's case is \$18,800 of depreciation expense that we will allow to remain for this purpose.

Redwood Creek/Floating Feather

The service to Redwood Creek was authorized by the Commission in the Company's Eagle area certificate case. Reference Case No. EUW-W-94-1. The source capacity for the area is 5.0 MGD. Currently usage for domestic and fire protection is 2.17 MGD. The Redwood Creek project is a combination of purchased existing facilities and new facilities constructed by the Company. Tr. p. 611.

Utilizing a developed investment model (Exhibit 104) and Company derived input (27 customers; \$457 annual revenue per customer), Staff determined that of the \$890,269 investment requested in rate base by the Company for the Redwood Creek/Floating Feather acquisition, only \$66,019 of investment is supported by related revenue. Tr. p. 613. Staff therefore recommends that \$824,250 of the requested net rate base increase for Redwood Creek be disallowed. Tr. p. 613.

United Water in rebuttal contends that it is reasonable to use actual or projected rather than test year customer numbers and revenue in justifying the rate basing of its investment expense. Exhibit 15, Tr. pp. 854-856. Utilizing current customer numbers (52) and revenue (\$409 annual revenue per customer) the Company contends that \$114,000 of investment is supported. United Water contends however that Staff's model is inappropriate for determining rate base in the Redwood Creek/ Floating Feather area. The Company recommends inclusion of the entire \$890,269 based on its planning determination that the surplus water was needed to supply customer demand in the Company's main service level, and its construction of a pipeline to transport the water. The investment, it states, is now linked to the Company's integrated system, and is now used and useful. Tr. pp. 856, 858. Staff challenges the prudence of the Company's decision to construct the pipeline to connect the Redwood Creek/Floating Feather area to the Company's main service level.

We find:

In assessing this investment, we rely on the Company's prior assurances in Case No. EUW-W-94-1 that it would not be asking its existing customers to subsidize its Eagle area investment. We also find that Staff's investment model is acceptable for calculating the amount of investment supported by revenue and the amount of related subsidy.

The Company contends that because it has constructed three and one-half miles of main line and connected the heretofore isolated Redwood Creek/Floating Feather System with its greater integrated water system, that its entire investment in the Eagle area facilities has now been made

“used and useful” and should be rate based. As explained above, the Commission has denied ratebase treatment for the main line. Despite the physical connections of Redwood Creek with the Floating Feather Well, it is clear that the pipeline was intended to primarily access water supply provided by the Floating Feather well. Accordingly, we find it reasonable for rate base purposes to separate the Floating Feather well from the rest of the Company’s Redwood Creek investment. Beyond that however, there is reason to question the Company’s pipeline investment, its timing and its reasonableness as discussed above. Based on our analysis and decision to deny rate base treatment of the pipeline, we find that Staff’s investment model analysis is appropriate for Redwood Creek/Floating Feather.

Included in the Company’s depreciation expense is \$27,646 related to the Redwood Creek/Floating Feather well investments. Of this amount, \$11,927 is related to the Floating Feather well. We will allow the \$11,927 expense to remain in the revenue requirement calculation to provide for amortization of the Company’s investment in the well. We do this in recognition of the fact that the Floating Feather well is presently being used as a source supply for the northwest pipeline.

Island Woods

Service to Island Woods was authorized by the Commission in the Company's Eagle area certificate case. Reference Case No. EUW-W-94-1, Order No. 26337. Island Woods is an independent water system that is not connected to the Company's larger distribution system. Tr. p. 43. United Water paid \$276,150 and \$103,850 respectively for Island Woods supply and distribution facilities. Tr. p. 42. The source capacity of Island Woods wells is 2.6 million gallons per day or 1,800 gallons per minute. Current demand requirements for source are 62% of current capacity, 1,000 gallons per minute for fire flow and approximately 120 gallons per minute for peak hour domestic service. Tr. p. 43. The Company proposes including its entire Island Woods investment in distribution in rate base, reasoning that with 81 Island Woods customers in September 1997 the Company's Line Extension Rule in effect at that time would have supported an investment of \$113,400. Based on its demand analysis, the Company proposes including only 62% of its supply investment in rate base, with the remainder being placed in plant held for future use. Tr. p. 43.

Utilizing a developed investment model (Exhibit No. 103) and Company derived input (84 customers; \$435 annual revenue per customer) Staff determined that of the \$260,751 requested for rate base by the Company for the Island Woods water system, only \$187,351 of investment is supported by related revenue. Tr. p. 613. As described by Staff, the model determines the incremental increase in revenue requirement due to increased operating expenses, taxes and depreciation expense. The increased revenue requirement is then compared to the incremental increase in annual revenue generated from the new customers to determine if the Company will earn its authorized return on investment. If insufficient new revenue is generated, then, Staff contends, investment must be reduced or the general body of ratepayers will be required to subsidize the acquisition. Staff therefore recommends that \$73,400 of the requested net rate base increase for Island Woods be disallowed. Tr. p. 613.

United Water in rebuttal contends that it is reasonable to use actual or projected rather than test year customer numbers and revenue in justifying rate basing its investment expense. Exhibit 14; Tr. pp. 852, 948, 949. With projected numbers the Company argues that ratebasing its entire requested investment is justified. Utilizing current customer numbers (90) and revenue (\$491 annual revenue per customer) the Company contends that \$230,800 of investment is supported. The

Company proposes no pro forma adjustment to either its customer numbers or revenue numbers in this case. Tr. pp. 643, 950.

The Company further contends that rather than look at Company acquisitions on a stand-alone basis regarding any subsidy that may be required, the Commission should consider the overall materiality of the subsidy or determine in light of other benefits that may be associated with the transaction, that some immaterial amount of subsidy might be acceptable. Tr. pp. 637, 638.

We find:

In our final Order No. 26337 in Case No. EUW-W-94-1, the Commission approved the Company's requested certificate. Our recitation of facts in that Order reflects the following language: Commission Staff, based on its analysis of project economics, area growth and projected revenue, characterized United Water's investment in the Eagle area as speculative. United Water admitted that Eagle area revenue in the near term might be insufficient to cover Eagle area investment. Existing UWI customers, United Water nevertheless assured the Commission, would not be asked to subsidize the new customers in the Eagle area.

In our findings, we stated, "A regulated water utility is at risk in extending into, acquiring property and investing in non-contiguous areas without a prior certificate." Order No. 26337.

Despite its prior assurances to the Commission and its customers, the Company is now before us arguing that we should not consider the customer numbers used by the Company in its test year revenue calculations but instead higher actual or projected numbers to assess the investment supported by revenue; the Company also asks us to consider whether some immaterial amount of subsidy might be acceptable. We cannot adopt the Company's proposal. Our previous approval was done in reliance on Company assurances that the costs of the acquisition would not adversely impact other customers. We also find that we must be consistent in the use of customer numbers and revenues and expenses to avoid unreasonable mismatches. We find that Staff's investment model presents an acceptable methodology for determining revenue supported investment. \$73,400 is not an immaterial amount. We accept Staff's proposed adjustment and approve rate basing of \$187,351 of the Company's Island Woods investment in this proceeding.

Capitalized Corporate Overhead.

Because of a perceived potential for interaffiliate subsidies, Staff proposes to remove capitalized overhead costs charged to construction projects for a three-year period ending June 1997 for fees and expenses charged to United Water Idaho by United Water Resources and the M&S Company. Reference Exhibit 118, pp. 1, 2; Tr. pp. 520, 521.

The capitalized overhead adjustments in this case, the Company states, are engineering costs incurred through the M&S Company on behalf of the customers of United Water Idaho. Tr. p. 992. United Water points out that Staff's adjustment would effectively eliminate overheads that were already approved by the Commission in the 96-3 case, which was based on a test year of 1995 (Tr. p. 569), and would deny the Company an opportunity to earn a return on the value of services capitalized in this case. Tr. p. 570. Referring to Staff Exhibit 118, the Company notes that since 1994 the rate of overhead accrual has actually gone down, that overheads were accruing at a rate of 3.5% through the 1994 period, 3.4% in the 1995 period and from 1996 to present have ranged from 2.4% and now are at about 2.9%. Tr. pp. 572, 573.

We find:

The Company's argument in this instance is persuasive. Staff was unable to provide any evidence of interaffiliate subsidies charged to United Water. Although it appears that the overheads are percentage loading and not based on time, it is also clear that affiliate services were provided to Idaho. The established record does not support the Staff proposed disallowance.

Boise River Intake

The Boise River intake project is comprised of 2900 feet of 30 inch discharge main through the Surprise Valley Canyon wall cut for Highway 21 and a river diversion structure. The purpose of the intake/transmission main is to supply Boise River water to a future service water treatment plant. The Company anticipates that diversion waters will be required to meet projected southeast Boise demand in year 2005. The southeast Boise area lacks adequate ground water and has been designated a Ground Water Management Area. It is also an area targeted for significant growth (residential, commercial and industrial) in Boise City's Comprehensive Plan and other planning documents, with current and future customer growth projections exceeding 8% per year. Tr. pp. 25-31.

To meet future demand in southeast Boise the Company explored four potential sources of supply: (1) wells within the area (no available supply), (2) wells outside the area (Southeast Boise Water Supply Project limited by capacity and time), (3) the Marden water treatment plant (design capacity and transmission constraints), and (4) a new water treatment plant. Tr. pp. 31-33. Based on its analysis, the Company concluded that a new water treatment plant, located in the vicinity of the Columbia bench was the only viable alternative source of supply for the area. The most feasible site for a river intake and pumping station was determined to be the site of an existing pumping station used by the Harris family for irrigation. Tr. pp. 33-35.

The Company's decision to go forward with the river intake project at this time, it states, was based on a number of factors: (1) opportunity to utilize an existing diversion, (2) avoidance of perceived legal challenges to a new diversion, (3) opportunity to join and share construction costs with Micron Technology, J.R. Simplot Company and Surprise Valley L'td Partnership, who independently were working on a proposal to upgrade the existing river diversion, (4) timing of construction dictated by forces over which United Water did not have control—Micron/Surprise Valley needed water by spring of '98; mandate of Idaho Department of Transportation and (5) its obligation to serve. Tr. pp. 35-38.

The Company states that it saw no other viable alternative for future water service to the southeast Boise area. If the structure was not completed at this time, it states, it would have been impossible to install facilities at a later date. Tr. p. 39. Recognizing that there is no immediate need for the diversion waters to meet demand, the Company notes that the facilities constructed are only

those which could not be delayed until the treatment plant is built—i.e., no pumps, electrical equipment or other mechanical equipment have been installed. Tr. pp. 37, 38.

Except upon a finding of an “extreme emergency”, the Commission is prohibited under *Idaho Code* § 61-502A from setting rates for any utility that grant a return on construction work in progress (CWIP) or property held for future use which is not currently used and useful in providing utility service. United Water contends that its investment in this instance was incurred in response to an “extreme emergency” and “undertaken in response to a mandate from government to either install the facilities now or be precluded from ever installing them.” The Company did concede that “the only written document that it has from the Idaho Department of Transportation is a permit which said that this line construction will be done prior to paving of the roadway.” Tr. p. 973. As represented, the Company perceived that it had no viable alternative and therefore concluded that it had no choice but to make the investment now. Tr. pp. 39, 81. The Company denies that its decision to construct was based merely on its opportunity to share construction costs. Tr. p. 38. The Company maintains that it is reasonable that existing customers share in the cost of planning and development; that the length of time to develop a new source of surface supply is five to seven years. Tr. pp. 880, 881, 948. It thus requests that its investment be included in rate base. The annual revenue requirement associated with its investment is approximately \$306,000. Tr. p. 624.

The Idaho Citizens Coalition opposes including the Boise River diversion in rate base until it is “used and useful.” Reference *Idaho Code* § 61-502A. The installed facilities, it states, are not providing water service to customers, there are no pumps installed, there is no related water treatment plant, indeed the Company does not even have water rights that would allow it to operate the diversion. Tr. p. 691. The Company, the Coalition states, has built ahead of need and actual use. This is a plant designed for future use. Tr. p. 692. The Coalition maintains that a lower cost business opportunity does not constitute an “extreme emergency”; that United Water assured the City of Boise that it would not seek to include the project in rate base until it was fully used and useful (reference Exhibit No. 110); that intergenerational equity demands that current customers not be required to pay for facilities that will not be required until the year 2005 (see Tr. p. 878); and that normal market conditions would impose a similar discipline on competitive business. Tr. pp. 693-695.

We find:

The Company in this case presents us with no physical evidence or documentation of a “mandate from government” of such a nature that we could find the “extreme emergency” exception to *Idaho Code* § 61-502(a) exists. Its professed belief that it was subject to such a mandate and that it would have been precluded in the future from **ever** installing facilities at the Highway 21 cut is not supported by persuasive evidence. Based on Company demand forecasts there will be no need for the facilities until the year 2005. This is a pipe that goes nowhere and is not hooked up to anything. The Company’s investment is not presently “used and useful.” Rate basing is therefore prohibited under *Idaho Code* § 61-502(A).

We find, however, that the Company’s decision to install facilities now may be of future benefit to its customers. We do not wish to discourage the Company from making decisions that make good business sense. Certainly, in this instance, the opportunity to share construction costs and utilize an existing diversion with others was an incentive to action. We, therefore, find it reasonable to allow amortization of the Company’s present investment in the Boise River intake project so that this investment will be recovered. We note that the Company’s calculation of depreciation expense in this case includes an allowance for this project, of \$37,651. That expense allowance is approved in this Order to provide for the recovery of this investment.

**Transportation Adjustment for Leased Vehicles
Restore Book Value One Vehicle to Rate Base**

Staff proposes an adjustment to make a correction for a change in the Company's plans for replacing a vehicle and eliminate some capitalized costs of the Company's vehicle leasing program. Tr. p. 515. The adjustment removes from rate base the extra costs the Company incurred through its vehicle leasing program. Tr. pp. 522, 526, 527; Exhibit 119, p. 1. By this adjustment, Staff continues to challenge the Company's switch from ownership of its vehicle fleet to leasing, the Company's failure to present a persuasive cost/benefit analysis of lease versus own, and to articulate and credit customers with offsetting savings. Reference Order No. 26671, UWI-W-96-3; Tr. pp. 522-524. Company assumptions regarding vehicle residual values, Staff contends, are artificially low and adjusted to favor leasing. The actual experience of UWI over the last few years, Staff maintains, demonstrates unequivocally that the residual values are wrong and that leasing is more costly to the Company. Tr. pp. 524, 525; Exhibit 119, p. 2; Exhibit 118.

The methodology employed by the Company in its cost/benefit analysis in this case (Exhibit 22) is essentially the same methodology presented in UWI-W-96-3. Tr. p. 1079. United Water interprets the Commission Order in Case No. UWI-W-96-3 as generally accepting the Company's cost benefit analysis. Tr. pp. 104-106, 1081. The Company's analysis, it states, has been presented and accepted by the majority of the states in which United Water operates. The Company disputes Staff's continuing contention that its cost/benefit analysis is flawed and superficial, arguing rather that it is instead well thought out and comprehensive. Tr. pp. 1008-1010; Exhibits 22, 23. The Company further disputes Staff's contention that its vehicle residual values have been adjusted to favor leasing and contends that Staff analysis is not based on utility vehicles, which experience extremely hard service lives. Tr. p. 1010.

We find:

Pursuant to a policy that seeks to take advantage of economies of scale, the Company continues its transition from vehicle ownership to leasing. We recognize that cost savings may be achieved with a uniform program in multiple states of operation. We are satisfied that the attendant costs and benefits were considered and weighed by the Company. Owning and leasing are both reasonable and viable alternatives. Although the related expenses may vary, we find that the

Company is not legally constrained to choose the least cost alternative. The expense incurred should be authorized if it is determined to be otherwise reasonable.

In this case, Staff disagrees with the Company's projected residual values contending that they do not comport with the Company's actual resale experience. We are seemingly being asked to judge projections and estimates under a leasing scenario with records developed under an ownership scenario, and to then make a decision as if the own versus lease cost equation can be simply reduced to the amount realized on resale. We think not. The Company's proposed lease expense and related rate base adjustment has not been shown to be unreasonable. We reject Staff's proposed leasing adjustment. We approve restoring the \$3,500 book value of one vehicle to rate base.

Rate Base Calculations

Following are the calculations for United Water's approved rate base:

| | |
|---|---------------------|
| Plant in Service | |
| Per Company Ex. No. 20, Page 1 | \$137,099,238 |
| Less Northwest Pipeline | (940,000) |
| Less Portion of Island Woods | (73,400) |
| Less Portion of Redwood Creek | (824,250) |
| Less Boise River Diversion Project | <u>(1,882,531)</u> |
| Adjusted Total Plant in Service | \$133,379,057 |
| Less: (Per Company Ex. No. 20, Page 1) | |
| Accumulated Depreciation | (27,573,584) |
| Customer Advances for Construction | (2,112,097) |
| Contributions in Aid of Construction | (19,725,787) |
| Utility Plant Acquisition Adjustment | (208,028) |
| Accumulated Deferred Income Taxes | (5,384,478) |
| Net Adjustment for Island Woods (Co proposal) | (99,476) |
| Pre 1971 Investment Tax Credits | (22,594) |
| Add: (From Co. Ex. No. 20, Page 1) | |
| Deferred Charges | 281,195 |
| Working Capital | <u>1,890,078</u> |
| | <u>\$80,424,286</u> |

III Operating Results

As reflected in its initial Application the increase in annual revenue requested by the Company was \$3,424,516 or 15.47%. As set forth in Company rebuttal Exhibit 20 a revised annual revenue increase of \$3,134,039 or 14.27% is requested. Tr. pp. 1000, 1001.

The Company has agreed to and incorporated into its rebuttal Exh. 20 results of operations, the following Staff proposed adjustments to operating expense:

- Ad valorem adjustment—(Co. Post Hng Exh 33) (\$13,265)*
- Correct info collection rule (SDWA) test schedule (\$ 2,810)
- Correct purchase water double count (\$ 1,800)
- Correct employee health insurance \$ 9,634
- Correct employee thrift plan (\$ 446)
- Correct telemetry expense (\$ 7,123)

The Commission Staff has further agreed to reverse a proposed Exhibit 115, Column K (\$3,947) payroll tax adjustment, as Staff agrees that it is a duplication of an adjustment already made by the Company. Tr. pp. 104, 1021-1023.

Also agreed to is a (\$168) adjustment to correct the Company's PUC annual regulatory fee assessment to the 1998 actual amount. Tr. p. 157. The pro forma annual IPUC assessment expense is \$51,807. We find the substitution of actual expense for estimated expense to be reasonable.

On May 18, 1998, the Company submitted a second amended Exhibit No. 5 Schedule 1, p. 7 setting forth amended power cost calculations based on test year usage and Idaho Power Company rates as of 5/16/98. Reference Order No. 27516. The related corrected adjustment increases test year expense by \$74,484, rather than the decrease of \$31,807 originally proposed and included in the Company's rebuttal Exh. 20 operating expenses. The effect of the amended calculation is an increase of \$106,291 to the operating expenses reflected in Exh. 20. This adjustment affects the operating ratio adjustment calculation. The pro forma annual purchased power cost is \$1,110,698. We find the use of current electric rates in the Company's power cost calculations to be reasonable.

*Corrected adjustment number based on the actual 1998 market value appraisal of \$70,956,346

Eliminate Depreciation Expense Equity Gross-Up

Staff made an adjustment to rate base to eliminate the capitalized AFUDC gross up. The Company agreed with the adjustment and reflected the \$54,753 rate base adjustment in rebuttal Exh. 20. Tr. p. 1039. The depreciation expense associated with the amount removed from rate base must also be removed from expenses. The depreciation expense adjustment is \$1,617 (\$80,857 rate base, 50 year life).

We Find:

Staff's uncontested \$1,617 adjustment to depreciation expense is proper and makes the capitalized AFUDC gross-up revenue neutral as provided by FAS 109. (Exh. No. 26).

Adjust Transportation Expenses

United Water's transportation expense reflects 43 leased vehicles with an average lease term of approximately 3.5 years. This proposed adjustment carries through Staff's correction related to the Company's switch from ownership of its vehicle fleet to leasing, proposes to eliminate lease expense in excess of historical expense with ownership, and reduces the Company's proposed level of operating lease expense from \$286,800 to \$171,402. Exh. 119 p.1; Tr. pp. 527, 529.

The Company disputes Staff's criticism of its lease versus own cost/benefit analysis and believes that the Staff proposed 40.24% reduction in expense allowance for leased vehicles is unreasonable. Tr. p. 1010. Staff's seeming reliance on the fact that the Company's transportation overhead rate has increased from 6.5% to 11.5% from 1994 to 1997 as an indication that leasing is more expensive than vehicle ownership, the Company states, is erroneous in that the Staff ignores the other side of the equation, the fact that owned vehicles also require a return on rate base and the associated income tax impact. Tr. p. 1011. See additional Company analysis, Exhibit 24, Tr. pp. 1012-1018. On rebuttal the Company proposed a \$21,400 reduction in the level of transportation expense requested based on expected lease residual values flowing back to the Company on approximately 12 vehicles/yr from American Leasing Corp. Tr. pp. 1008, 1018; Exh. 20, p. 3.

We Find:

For reasons expressed in our related rate base discussion above, we find vehicle ownership and leasing are both viable options available to the Company. We find the Company's decision to switch from vehicle ownership to leasing to be a reasonable business choice. Staff has not demonstrated that the Company's transportation and vehicle lease expenses are unreasonable. The Company on rebuttal proposes a \$21,400 reduction in lease expense to reflect projections that its leasing company will realize 20% more for the Company's vehicles than the residual value utilized in calculating the lease payment. We approve the adjusted expense level of \$265,400.

Adjust PUC Rate Case Expense

Under the Company's proposal, test year expense is increased by \$115,654 for the amortization of current rate case expense and the unamortized balance of two prior proceedings, the connection fee case (UWI-W-96-4) and the water quality (UWI-W-96-6) investigation. Exhibit 5, Schedule 1, p. 18. The Company estimates that the current rate case will cost approximately \$300,000 to which \$36,813, the unamortized balances from the prior proceedings, is added to reflect a total unamortized balance of \$336,813. The \$336,813 is divided by two years to reflect an annual amortization of \$168,407. Deducting test year expense of \$52,753 produces an adjustment of \$115,654. Tr. p. 124.

Staff as detailed in Exhibit 120 adjusts UWI's estimated rate case expense to split these costs between customers and shareholders. Staff further adjusted expenses for other PUC cases to amortize these non-recurring charges over a five (5) year period rather than two (2) as requested by the Company. Tr. pp. 530-532.

The Company agrees on rebuttal that a five-year amortization period for the deferred regulatory expense related to the connection fee and water quality cases is reasonable due to the non-recurring nature of such cases. Tr. p. 1023. The Company did not however make any adjustment in its rebuttal exhibits to recognize its agreement. The Company notes that through its efforts to control costs, its current estimated rate case expense is lower than costs actually incurred in its last general rate filing. Tr. pp. 1024, 1025. Company witness Healy disputes Staff's contention that a double counting of his rate case costs has occurred, stating that the costs of his time related to rate case functions is not included in the deferred rate case cost, it is only reflected in the Company's O&M expense. Tr. p. 1025.

The Company notes that during the discovery process it provided Staff and intervenor Sharon Ullman with a break down of estimated rate case expense and also copies of actual invoices, bills and contracts supporting actual costs received to date. Tr. p. 1027. Neither Staff nor Ms. Ullman, the Company states provided any analysis or reasoning supporting their conclusion that rate case expense was too high. Tr. pp. 1027-1031.

We find:

The Commission finds the Company's estimated general rate case expense to be reasonable. We understand said expense to include both the revenue requirement and cost of

service/rate design phases. We understand that embedded in its estimate are attorney fees and intervenor funding. We find no justification for requiring the Company to split rate case expense between customers and shareholders. United Water and Staff propose amortizing the costs of the current rate case over a two year period. We find that a three year amortization for rate case expense provides a more responsible matching of costs to the time period in which they are incurred. We accept the reasonableness of a five year amortization period for the deferred regulatory expense related to the make whole, connection fee and water quality cases, \$36,813. We further allow the Company total general rate case expense of \$300,000 amortized over three years. The following table reflects the rate case expense adjustment of (\$61,044) to the pro forma test year.

United Water Idaho
Staff Adjustment to
Rate Case Expense Amortization

| | | |
|---|----------------|--------------------------|
| 1. Current Rate Case Expense (Ex 5, Sch 1, Pg 18) | \$300,000 | |
| 2. Ratio of Expense to customers | <u>100.00%</u> | |
| 3. Expense to be passed through to customers | \$300,00 | |
| 4. Amortization period in years | <u>3</u> | |
| 5. Annual Amortization Expense | | \$100,000 |
| 6. Other Case Expenses (Ex 5, Sch 1, Pg 18) | \$36,813 | |
| 7. Amortization period in years | <u>5</u> | |
| 8. Annual Amortization Expense | | <u>7,363</u> |
| 9. Total Amortization Expense | | \$107,362.6 |
| 10. Test Year Amortization Expense (Ex 5, Sch 1, Pg 18) | | <u>52,753</u> |
| 11. Required Adjustment to Test Year | | \$54,609.6 |
| 12. Company proposed Adjustment (Ex 5, Sch 1, Pg 18) | | <u>115,654</u> |
| 13. Adjustment to Company's Performa test year | | <u>(\$61,044)</u> |

Adjust Operating Ratio Adjustment

This Staff proposed adjustment as detailed in Exhibit 121 is intended to synchronize expenses related to the effects of customer growth and weather with the Company's variable operating expenses that are sensitive to these changes. Tr. pp. 532, 533.

The Company agrees with Staff's methodology, except for one point. Staff, it contends, has substituted the level of transportation expense on line 3, column b of Exhibit 121, thus lowering the ratio of growth related expenses to revenue. The calculation of this adjustment, the Company contends, cannot be made until a level of transportation expense is decided. Tr. pp. 1032, 1033.

We find:

Having made our decisions in this Order regarding the authorized level of transportation expense and power supply cost, a recalculation of the operating ratio adjustment under the agreed methodology results in a decrease in Company operating expenses, as reflected in Company rebuttal Exh. 20, in the amount of (\$739).

Reverse Adjustment for M&S Fees

Services provided to United Water Idaho from United Water Management and Services (M&S) are provided pursuant to an agreement between the companies. Test period level of Management and Service charges were \$868,565. The Company states, however, that due to recording variations, this level is not representative of the annual expense. The 1997 charge which contains seven months actual data and five months projected data, indicates a pro forma level of Management and Service charges of \$948,643 or \$80,078 higher than the test year level. This higher figure, the Company contends, reflects the level of services received. Tr. pp. 121, 122. Because it is simply a budgeted number and not based on known and measurable expense, Staff reverses this adjustment by the Company. Tr. p. 533.

The Company on rebuttal contends that Staff has identified no cost or charge that is unreasonable, excessive or imprudent. Staff's adjustment, it states, is simply the amount by which the Company has adjusted the test year level of expense, and is not the product of any logic, reasoning or calculation. Tr. p. 1033.

United Water contends that utility management has both the obligation and right without Commission second guessing or micro management to manage the business and overall expenses within categories if the overall result within the category is not unreasonable. Tr. pp. 549, 550. By way of rebuttal, the Company in Exhibit 25 presents a schedule depicting UWI Management and Service fee expense as a percentage of total operations and maintenance expense. The 1991 through 1996 actual average is 10.73%. Tr. pp. 555, 1033-1035. Staff on cross admitted that it had no testimony or information to indicate that management/service fees at this relationship or level in comparison to O&M generally is unreasonable. Tr. p. 555. The Company also presents other possible scales of reference for use in evaluating the significance of the proposed management/service fees. Tr. pp. 556-558. Suspicion alone, the Company contends, should not trigger a disallowance. Tr. p. 559.

We find:

In examining payments to affiliates we apply the rule announced by our Supreme Court in *Boise Water Corp. v. Idaho Public Utilities Comm.*, 97 Idaho 832, 555 P.2d 163 (1976) and *General Telephone Company v. Idaho Public Utilities Comm.*, 109 Idaho 942, 712 P.2d 643 (1986)

Although the company may have established actual incurrence of these operating expenses, that fact alone does not establish a prima facie case of reasonableness with respect to payments to affiliates. (Citations omitted). Charges arising out of intercompany relationships should be scrutinized with care.

97 Idaho at 836-837.

In this case we find that the Company proposed adjustment for budgeted increases in fees paid to the M & S Company is a projection not based on actual known and measurable data. It is simply a 5% increase percentage assessment over year end 1996 annual expense. A mere statement that the higher figure reflects the level of services received does not establish the reasonableness of the increased payment to M & S. We therefore find that Staff's proposed adjustment is proper.

Adjust Depreciation Expense IT and Master Plan

The Company in its case used a 10-year life for calculating depreciation expense on its investment in the Information Technology (IT) program and the Master Plan. The IT system, the Company states, replaces a 20-year old main frame that was essentially obsolete. The conversion to a new information system, Staff contends, is not a normal occurrence and it is unreasonable to expect that in ten years the Company will scrap all of its technological equipment and software and start over from scratch. Tr. pp. 531, 533. Likewise, Staff contends, that the Master Plan is an unusual long-term project. Staff proposes that both investments be depreciated over a 20-year period. Staff's adjustment is simply a 50% reduction in the Company's pro forma depreciation adjustment.

On rebuttal, the Company contends that the ten year life proposed for its investment in Information Technology is based on a realistic assumption of service life, given the rapidly evolving nature of computer equipment. *Citing Pennsylvania PUC concurrence*, Tr. pp., 1040-1042. The replaced main frame equipment, the Company reminds the Commission, was a system that was added to, upgraded, retired and modified during the course of its 20 plus years. Tr. p. 1042. Reason would suggest, the Company contends, that a 20-year depreciation period for IT equipment is based on flawed logic.

Regarding its Master Plan, the Company on rebuttal notes that, although its master engineering and operations plan is intended to provide guidance to the Company for many years, the plan contemplates a five-year update cycle to keep it fresh and responsive to the dynamic growth in the Company's service area. Key aspects of operations, the Company contends, can change substantially over a ten-year period. For instance, ten years ago UWI did not anticipate that southeast Boise would be designated a Ground Water Management Area. The conclusions of the Treasure Valley Hydrologic Study may have a potential similar impact in the next ten years. For these reasons, the Company contends that a ten year depreciable life is reasonable. Tr. p. 1044.

We find:

The Company's argument for using a 10-year life for calculating depreciation expense on its investment in its Information Technology program and Master Plan is persuasive. Staff's proposed adjustment is rejected.

Replacing Employee with Contractor

On rebuttal the Company proposes an adjustment to reflect the removal of a proposed new employee (a locator) and attendant labor, benefit and transportation costs as reflected in its direct case and the replacement of this function with contract expense. A locator's job is to "mark-out" mains and service locations for others who are excavating. The Company states that in 1997 it received approximately 68 "mark-out" requests per day. The Company has one employee dedicated to this function who is unable to perform the number requested. Tr. p. 51. Contract expense is estimated to be \$58,240 based on the historical level of locator requests, a \$13,013 increase over the \$45,227 proposed employee costs. Exhibit 21; Tr. pp. 1003, 1004. The Company maintains that "the long-term benefit to the customer is clear." Tr. p. 1004.

By unattested faxed copy of a post-hearing agreement dated June 22, 1998, it is represented that the Company has purportedly contracted with one Melvin L. Cook dba Mel's Locating Company, Nampa, Idaho for locator services. Compensation is at the rate of \$8.00 for each underground facility located and marked by contractor. The Company reserves the right to increase or diminish the amount of work to be done with regard to the services to be performed.

We find:

The Company's proposed rebuttal adjustment is an out of test year adjustment for an expense that is not actual but estimated. No money has been spent. We find that it is not sufficiently known and measurable. We find that the post-hearing contract will not be included as a record exhibit. The hearing record is closed. We therefore find it reasonable to deny the Company proposed adjustment for contract expense.

Adjustment for Salary and Benefits Survey Participation

In the discovery phase of this case, Ms. Ullman requested that the Company provide a copy of the Western Management Group 1997 Idaho Cross-Industry Salary and Benefit Survey results, a survey in which UWI participated. The Company responded that it was contractually precluded from disclosing or sharing the results. In Order No. 27449 the Commission indicated that it expected the Company to make an adjustment to reflect removal from its revenue request, the expense incurred due to its participation in the Western Management Group Salary and Benefit Survey. The Company reports that no adjustment is indicated, as the billing was paid in July 1997, outside the test year period. See Exhibit 30; Tr. p. 1054..

We find:

In as much as the Company's payment to the Western Management Group did not fall within the test year period, we find that there is no need for an adjustment, as proposed.

Depreciation Expense Adjustments—Redwood Creek/Island Woods

We find:

Having disallowed a portion of the Company requested rate base for Redwood Creek and Island Woods, the Commission finds that the proportionate related depreciation expense included in the Company's case should be removed. For Redwood Creek, that amount is \$15,719; for Island Woods the amount is \$1,468.

Depreciation Expense Adjustment—Capitalized Corporate Overhead

We find:

Having disallowed Staff's proposed adjustment related to capitalized corporate overhead, we also disallow the proposed \$16,242 elimination of related depreciation.

Operating Results Calculation

Following is the calculation of United Water's operating results based on the revenues and expenses approved in this Order.

OPERATING RESULTS SCHEDULE

| | |
|---|---------------------|
| Revenues Per Company Exhibit 20, Page 3, Column O | \$21,962,493 |
| Eliminate Micron Reuse/Efficiency Adjustment* | <u>173,482</u> |
| Net Revenues | <u>\$22,135,975</u> |
| | |
| Operating Expenses Per Co Ex 20, Page 3, Column O | 14,322,231 |
| Correct for: | |
| Ad Valorem Tax (Co. Post Hearing Exhibit) | 5,709 |
| Pumping Power (Co Post Hearing Exhibit) | 106,291 |
| Micron Reuse/Efficiency Adjustment* | 9,594 |
| PUC Regulatory Fees | (168) |
| Rate Case Amortization Expense | (61,044) |
| M&S Co. proforma adjustment | (80,078) |
| Locator Expense | (58,240) |
| Adjust Depreciation Expense- Redwood Creek | (15,719) |
| Adjust Depreciation Expense- Island Woods | (1,468) |
| Adjust Depreciation for Equity Gross-up of AFUDC | (1,617) |
| Recalculate Operating Ratio | <u>(739)</u> |
| | |
| Total Adjusted Operating Expenses | \$14,224,752 |
| | |
| Operating Income Before Income Tax | \$7,911,223 |
| Idaho Income Tax | 311,466 |
| Federal Income Tax | <u>1,205,827</u> |
| Net Utility Operating Income | <u>\$6,393,930</u> |

*See following VI C discussion re: Micron Reuse/Efficiency Adjustment.

IV Rate of Return Capital Structure

United Water Idaho Inc. is wholly-owned by United Water Works (formerly General Waterworks Corp.), which is wholly-owned by United Water Resources, Inc. Tr. p. 252. The actual capital structure of UWI is 100% equity. Tr. p. 288. Interest expense is allocated to UWI. United Water Idaho Inc.'s common stock is not traded.

One of the issues in this proceeding is the capital structure that should be adopted for the regulated United Water Idaho Inc. Testimony on this issue was presented by Frank J. Hanley (AUS Consultants) for the Company and Terri Carlock for Commission Staff. Post-hearing briefs were also submitted. The following schedule sets forth the related recommendations of each:

| COMPONENT | CAPITAL STRUCTURE | |
|--|----------------------|---------------|
| | RATIO (UWI) | RATIO (STAFF) |
| Long-term debt | 54.98% | 52.0% |
| Minority Interest (Preferred Stock) | 0.14% | 8.0% |
| Common Equity | 44.88% | 40.0% |
| TOTAL | 100.00% | 100.00% |

Reference UWI Exhibit 13, Schedule 8; Staff Exhibit 101, Schedule 17.

United Water employs the actual June 30, 1997 consolidated capital structure of its corporate parent, United Water Works (UWW). Tr. p. 248. The Company represents that this is appropriate because of the following:

1. UWW provides all of the external capital required by United Water;
2. No equity capital has been injected into UWW by its parent United Water Resources (UWR) since the April 1994 merger and thus UWW is not financially dependent on UWR;
3. UWR provides no financial guarantees, pledges, or any of its assets to any lender for the benefit of UWW;
4. No capital of UWR other than UWW could be used to finance United Water's rate base;

5. UWW capital structure ratios are reasonable vis-à-vis a proxy group of five water companies represented as generally similar in risk to United Water;
6. UWW capital structure ratios are consistent with those required by Standard and Poor's (S&P) for a water utility to maintain an A bond rating with an "average" business position, i.e., the business position of UWW. (S&P's total debt to total capital criterion for a water company in an average business position to obtain an "A" bond rating is 52% implying, the Company states, a total equity ratio of 48%. Tr. p. 301.)

Tr. p. 248.

In BOI-W-93-3, the Company's last general rate case, the Commission adopted a hypothetical rate structure for United Water's predecessor, Boise Water Company. Reference Order No. 25640. Commission Staff in this case rejects the Company's UWW capital structure and recommends continued use of the hypothetical capital structure approved in BOI-W-93-3. Tr. p. 479. Staff contends that its proposal is consistent with the Value Line water industry (Tr. pp. 462, 479) and S&P financial benchmark (Tr. p. 485) for a total debt to total capital ratio to maintain the S&P bond rating. Staff states that the stock is traded at the United Water Resource level with United Water Resource controlling the pay out ratio, and thus the retained earnings and common equity ratio for United Water Works. Tr. pp. 492-493; 499-503. This control, Staff contends, has the potential to skew the capital structure ratios lending further support for the use of the hypothetical capital structure for rate making purposes. Tr. pp. 495, 496.

The Company notes that at the time of the Commission's Order in BOI-W-93-3 there was uncertainty regarding the corporate relationships and resulting capital structure as indicated by the following Commission language: "Because the common equity ratio of GWC is expected to be 40% for 1994 and because United's common equity is expected to approximate 40% in the near term, we find that to be a reasonable equity ratio." Tr. pp. 288-290. The Company, citing various legal and regulatory principles, suggests that use of a hypothetical capital structure is appropriate only if the actual capital structure (UWW) is "clearly unsound or extravagantly conservative." Tr. p. 272. In support of the reasonableness of its position, the Company cites a recent Pennsylvania Commission case that found that for a sister subsidiary of UWW, United Water Pennsylvania, Inc., it was reasonable and appropriate to use UWW's capital structure. Tr. pp. 752-753. With only two exceptions (UWI's BOI-W-93-3 and a case involving United Water Delaware now on appeal to the

Supreme Court of Delaware) in recent history, the Company states that the subsidiaries of UWW and the former General Waterworks Corp. have been consistently regulated in their rate cases, both before and after the merger, on a basis of UWW's capital structure. UWI Brief, pp. 3-6.

It is to be noted that UWR's consolidated capital structure consists of 55.20% long-term debt, 8.51% preferred stock and 36.29% common equity. Exhibit 13, Schedule 3. The hypothetical debt ratio of 52% proposed by Staff, is less than the current debt ratio for UWR of 55.2% and the water utility industry average of 56.5%. The 52% debt ratio is also the same as the ratio stated for an "A" rated utility as set forth in Standard & Poor's Financial Benchmarks (Exhibit 13, Schedule 7, p. 3 of 4). Exhibit No. 101, Schedule 15 also reflects these comparisons. UWW's debt is rated "A" by S&P and UWR's credit rating is "A-." Tr. p. 297. The 8% minority interest in the hypothetical capital structure is consistent with the 8.5% preferred stock held by UWR.

United Water Idaho does not directly raise funds in the market. The debt funds are issued at the United Water Works level and the equity funds are retained through earnings or, as contended by Staff, raised at the United Water Resources level. Therefore, the actual capital structure shown on the books of United Water Idaho, Staff contends, has been provided by and supported by one of the parent entities. The UWI capital structure, Staff states, could be double leveraged to reflect this relationship. Rather than double leverage, however, Staff contends that a hypothetical capital structure is more appropriate. Tr. pp. 461, 462. The Company states that Staff's hypothetical capital structure is essentially the same as utilizing double leveraging. This is disputed by Staff, which presents but does not recommend an example of a double leveraged capital structure for UWI. Staff Brief Exhibit A.

The average capital structure ratios for the two proxy groups are depicted in Company Exhibit 13, Schedule 3, page 2. They are for the proxy group of five water companies, 52.19% long-term debt, 1.88% preferred stock, 45.93% common equity capital; and for the proxy group of six Value Line water companies, 55.15% long-term debt, 2.58% preferred stock, and 42.27% common equity capital. Tr. p. 760. The Value Line water industry average capital structure consists of 39.5% in 1997 and is projected to be 40% in 1998. Exhibit 101, Schedule 15.

The Company represents that its primary proxy group of five water companies (Exhibit 12, Schedule 5) is a better and more meaningful proxy than the group of six Value Line water companies. (Exhibit 12, Schedule 6), which was used by the Company as a check and relied upon

by Staff. Tr. pp. 280-283. The Value Line check group of six is dismissed by United Water as irrelevant in this case because the companies are much larger and more geographically diverse than United Water Idaho. Tr. pp. 756, 282. Excluding the purported nonrepresentative American Water Works and United Water Resources, Inc. which make up over three-fourths of the total capitalization of the group, Tr. p. 481, the 9/30/97 average capital structure for the remaining companies in the Value Line group would be 53.92% long-term debt, 0.94% preferred stock, and 45.14% common equity. Tr. p. 760.

We find:

The Company's argument for moving away from the hypothetical capital structure that we used in BOI-W-93-3 to the actual capital structure of its corporate parent, United Water Works (UWW) is persuasive. UWW is the entity that issues the debt for United Water Idaho. The UWW capital structure is currently within a reasonable range for utilities of comparable risk.

Cost of Capital

The principal proxy group of five water companies upon which the Company bases its recommended common equity cost rate yields a common equity range including 10.5% (two-stage growth DCF model); 11.6% (Risk Premium Model); 10.5% (Capital Asset Pricing Model) and 12.6% (Comparable Earnings Analysis). Exh. 13., Sch. 7, p. 4.

United Water in rebuttal Exh. 13, Sch. 8 proposes the following cost of capital and rate of return.

| | Capital Structure | Cost Rate | Weighted Cost |
|------------------------|-------------------|-----------|---------------|
| Long Term Debt | 54.98% | 7.80% | 4.29% |
| Minority Interest | 0.14% | 5.00% | 0.01% |
| Common Equity | 44.88% | 11.5% | 5.16% |
| Overall Rate of Return | 100.00% | | 9.46% |

The Company recommends a common equity cost rate of 11.50%. A point that includes a 20 basis point business risk adjustment, that it contends is appropriate to reflect UWI's extremely small size and the following four major risk factors:

1. Micron reuse program (sales to Micron represent approx 2% of United Waters total annual revenue).
2. Weather—Company realizes about 70% of annual revenue May-October; 12" annual rainfall; 87% of customers residential.
3. Surface water rights are difficult to acquire and increasingly costly.
4. Cost of power may increase with deregulation.

Tr. pp. 265-268, 776, 777.

Staff in Exh. 101, Sch. 17 recommends the following cost of capital and rate of return.

| | Capital Structure | Cost rate | Weighted cost |
|------------------------|-------------------|---------------|---------------|
| Long Term Debt | 52.0% | 7.80% | 4.06% |
| Minority Interest | 8.0% | 5.00% | .40% |
| Common Equity | 40.0% | 10.25%-11.25% | 4.10%-4.50% |
| Overall Rate of Return | 100.00% | | 8.56%-8.96% |

Differentials due to size and ultimate risk of the utility, Staff contends, should be reflected in the cost of common equity when a point within the reasonable return or equity range is

chosen. Staff contends that there is less risk inherent in the capital structure proposed by United Water, and if adopted, Staff would recommend 10.75% as a reasonable return on equity. Tr. p. 464. Staff also rejects the Company's contention that a business risk adjustment is required. Tr. p. 460.

Staff Exh. 101, Sch. 11 is a comparison schedule of thirteen (13) water company returns on equity for 12 months ending September 30, 1997. The returns range from 8.0% to 14.4%, with an average of 10.8%. Staff calculates the discounted cash flow (DCF) required return on common equity in the range of 8.5% - 10.7%. Exh. 101, Sch. 13. Staff also restates Company witness Hanley Exh. 12, Sch. 1, p. 2 on Exh. 101, Sch. 14 reflecting calculations shown as not meaningful by Hanley. For the five water company proxy group recommended by United Water, the single-stage growth DCF rate is shown as 9.8% (Exh. 12, Sch. 12) and the two-stage growth DCF rate is 10.5% (Exh. 12, Sch. 16, p.1).

Staff contends that any point within the range of 10.25% - 11.25% is reasonable for a return on equity. Tr. p. 464.

We find:

United Water contends that the use of UWW's capital structure is appropriate in the determination of the cost of capital for United Water Idaho. We approve that capital structure. The Company and Staff are in agreement on the cost rates for long-term debt and minority interest. The cost of debt has been adjusted for the debt refinancing in January and February of 1998. We find the respective rates reasonable and appropriate to use.

The Company also believes a 20 basis point business risk adjustment is required. We do not agree. The Company identifies four unique factors that it contends contribute to its increased riskiness. Regarding the Micron reuse program, the Company may present testimony and a related adjustment in the next phase of this case, if it can demonstrate that Micron's conservation program will result in a significant, known and measurable reduction in consumption. The potential for increased power costs due to deregulation, is highly speculative, especially in Idaho where electric restructuring has not been approved. Power costs are an operating expense for United Water. In this case, we have permitted an adjustment for an out of test year increase in power costs. Regarding the riskiness of surface water rights, we find that the Company in this case presents no evidence that it will have difficulty in securing water rights. Tr. p. 81. Regarding weather, the Company receives

an adjustment for weather normalization. The Company will have the opportunity to address rate design in the next phase of its case.

In considering the record, and the business, financial and regulatory risks of United Water, we find that a return on equity of 10.75% using the Company's proposed capital structure is a midrange return that fairly compensates the shareholders for the risks they assume by investing in United Water Idaho. We find that such a return also reflects our consideration of the quality of service and management provided by United Water.

To summarize, United Water's approved capital structure and overall rate of return are as follows:

COST OF CAPITAL

| Component | Ratio | Cost Rate | Weighted Cost |
|--------------------------------------|--------|-----------|---------------|
| Debt | 54.98% | 7.80% | 4.29% |
| Minority Interest | 0.14% | 5.00% | 0.01% |
| Common Equity | 44.88% | 10.75% | 4.82% |
| Required Rate of Return on Rate Base | | | 9.12% |

V Revenue Requirement

The Company's additional revenue requirement, which we find to be fair, just and reasonable, is \$1,593,095 calculated as follows:

| | |
|---------------------------------|--------------------|
| Rate Base | \$80,424,286 |
| Rate of Return | <u>9.12%</u> |
| Net Operating Income Required | \$7,334,695 |
| Net Operating Income Realized | <u>\$6,393,930</u> |
| Net Operating Income Deficiency | \$940,764.00 |
| Gross-up factor | 1.6816 |
| Revenue Increase required | \$1,581,989 |
| Percent Increase | 7.15% |

VI Miscellaneous

A. Timing of rate increase — Motion to Strike

On March 19, 1998, United Water filed a Motion with the Commission seeking to strike identified portions of the prefiled testimonies of Thomas Power and Sharon Ullman. Specifically, the Company sought to strike the portion of each testimony that proposed to defer the rate adjustment and recovery of any determined revenue deficiency until after completion of the cost of service and rate design phase of this case.

United Water contends that this issue has been decided; that in authorizing the bifurcation of the case, the Commission implicitly accepted the Company's proposal to begin recovery of any revenue deficiency found to exist in the revenue requirement phase of its rate case through an immediate uniform percentage increase. United Water contends that the Commission is without authority to extend the suspension period and that to delay any recovery would be to deny the Company an opportunity to earn its authorized rate of return, and would require it to perform its public service obligation without adequate compensation. Citing *Idaho Code* 61-622; *Citizens Util. Co. v. Idaho Public Util. Comm.*, 99 Idaho 164, 579 P.2d 110 (1978).

The intervenors argue that the statutory suspension period preproposes that the Company has filed a complete rate case, i.e., a case including "appropriate cost of service studies." Reference IDAPA 31.01.01.121.01.e. Dr. Power asserts that the bifurcated approach is merely a strategy of the utility to hold down public outcry and thereby enhance the possibility of a larger recovery. The Idaho Citizens Coalition contends that moving to strike testimony with which one disagrees is not an appropriate way to seek to affect the outcome of this case. The Coalition contends that United Water can argue its position regarding the timing of a rate increase (if any) in its rebuttal testimony, through its witnesses at the public hearings, through cross-examination of opposing witnesses, or it can make those arguments in brief. It also has the opportunity, it states, to call for reconsideration if it does not like the Commission's decision about the size and timing of any rate increase that is approved.

The Commission denied the Company's Motion in Order No. 27461, finding that the Commission's Order and Notices required no clarification, and apprising the Company that the Commission as fact finder and decision maker, was inclined to admit all relevant and arguably

reliable evidence and that it possesses the expertise to assess the relative probative value of evidence admitted.

At the hearing the Company renewed its Motion to Strike. Tr. pp. 404, 714.

We find:

For reasons expressed in Order No. 27461, we continue to find it reasonable to deny the Company's Motion to Strike. As to the intervenors underlying argument, we find that it was somewhat presumptuous of the Company to assume that it would not be necessary to present a full rate case, including cost of service and rate design. The Commission's Rules indicate what a general rate case filing should include. IDAPA 31.01.01.121. The Commission could have dismissed the Company's filing as incomplete. IDAPA 31.01.01.121.03. Nevertheless, we instead found its proposal to bifurcate to be an administratively efficient and judicious use of resources and a procedure that provided the Commission and parties a better opportunity for focused and thoughtful analysis and consideration of all the issues. Order No. 27293. We further found the proposed procedure to be a sequentially logical one and indicated the Company would be required to file a separate cost of service and rate design application within 30 days following the final Order in this proceeding. While we did not directly address the issue of the timing of any authorized increase in our prior Order, we find it reasonable and fair to allow the increase to go into effect now that a revenue deficiency has been found to exist.

B. UWI Motion to File Late Filed Exhibit No. 33 —

On June 11, 1998, United Water filed a Motion seeking to introduce the Company's Idaho State Tax Commission 1998 Market Value Appraisal. In Exhibit 5, Schedule 3, page 1, the Company estimated that the appraised market value for 1998 would \$70,624,792. The proposed late filed Exhibit 33 provides the Commission with the 1998 actual appraised market value, \$70,956,346.

We find:

The Commission notes that the appraised market value is used in determining the Company's ad valorem tax obligation, which is part of revenue requirement calculations. We find that an actual known and measurable market value is preferable to an estimated number and therefore find it reasonable to grant the Company's Motion and admit the late filed Exhibit 33.

C. UWI Rebuttal Adjustment— Micron Reuse/Efficiency Program

At hearing the Commission granted a Staff Motion to Strike regarding Company rebuttal testimony and related exhibits dealing with an adjustment it proposed for Micron consumption. Tr. pp. 726-731, 790-793. The Commission agreed the information regarding the projected change in Micron consumption was filed too late for the other parties to have an appropriate and meaningful chance to respond. The Commission granted the Company leave, however, to bring the issue back to the Commission as part of the cost of service/rate design phase of its rate case. Tr. p. 793.

We find:

The Commission reaffirms its decision granting Staff's Motion to Strike. The Company's proposed adjustment is accordingly rejected.

D. Ullman Challenges Re: Reasonableness of UWI Wage/Salary/Benefit Expense

Citing specific examples including the salary-benefit package of the Company's president and wages for meter readers, Ms. Ullman contends that the salary, wages and benefits offered by the Company are excessive and not comparable to area averages. No specific adjustments were proposed.

We find:

Based on the information presented and studies reviewed, we are unable to find that the Company's salaries, wages or benefits are unreasonable. We accordingly make no related adjustment in the Company's operating expenses.

VII Service and Water Quality (UWI-W-96-6)

The Commission in Order No. 27229 determined that the identified service and water quality issues raised in the filings and submitted investigative reports in Case No. UWI-W-96-6 (In the Matter of the Investigation of United Water Idaho Inc. and its Ability to Provide Adequate Service and Water Quality) were also at issue in this case. Staff Exhibit 112. The water quality issue identified in the 96-6 case was the presence of iron/manganese in the Company's source waters at levels exceeding the secondary maximum contaminate levels (SMCLs) listed in the federal Safe Drinking Water Act (SDWA). Secondary contaminants are classified as non-health threatening by the Environmental Protection Agency (EPA) and the State Division of Environmental Quality (DEQ). The problem manifests in the water as objectionable color, taste and odor.

Of the Company's 61 ground water wells included in Staff's report, 23 produced water that contained iron and/or manganese that exceeded the voluntary SMCLs. Those wells represented approximately 35% of the Company's total rated supply capacity. The problem is generally most acute during the summer months as demand increases.

The primary focus of the Company in dealing with customer water quality complaints is to reduce the amount of water supplied to the system from problem wells. The Company also sequesters at each problem well to keep the iron and manganese in solution. Additionally, the Company has proceeded with other possible solutions to replace existing problem supplies including investigating the use of aquifer storage and recovery (ASR), identifying aquifers of high quality water, and redrilling and replacing existing wells.

Staff in its report estimated that the Company in its effort to improve the aesthetic characteristics of its water was spending in excess of \$460,000 per year which represented about 2.3% of the Company's revenue collected from customers. Exhibit 12, page 16. In the instant case Staff identifies \$346,494 as revenue requirement related to improving aesthetic water quality.

The water quality improvement alternatives implemented or proposed by the Company are water system alternatives. Staff notes additionally that there are also in home water treatment alternatives that customers can implement, including mechanical gravity and pressure filters, iron and sulphur traps, ozone treatment, chlorine and charcoal filters, and reverse osmosis filters.

Staff concludes that the cause of water quality complaints within the Company's service area seems to be due primarily to high levels of iron and manganese introduced into the system to

varying degrees by existing production wells. However, it states, other factors such as the presence of iron bacteria, the layout of the distribution system, system flushing activities of the Company and the proximity of other wells of high quality seem to greatly influence how, where and when problems occur. In addition, customer perceptions, tolerances and expectations, it states, as well as Company communications and customer service drive the number of actual complaints that are used to determine the extent of the problem. Given the subjective nature of aesthetic customer complaints, Staff contends that it is difficult to determine how serious the problem is, how it is best addressed and how much money should be spent.

Addressing Staff's attempt to quantify the Company's aesthetic water quality costs, United Water contends that 100% of its revenue requirement is a result of supplying or improving water service to its customers, which includes its basic ability to serve, its compliance with EPA and DEQ standards, and its attempts to provide its customers with aesthetically acceptable water. Tr. pp. 874-876. Arguably the standard that the Company should adopt in the aesthetic area, it contends, is compliance with SDWA secondary standards. However, this approach it states may not always give the customers the best value added for the additional cost. Economy and efficiency, it states, must also be considerations. The measurement of success in its efforts, it states, may very well be reducing the number of customer complaints concerning the aesthetic water quality. Tr. p. 876.

In a November 1997 Status Report filed with the Commission regarding specific action plans to address water quality concerns, the Company represented that 1) it anticipated making application to DEQ and Water Resources by February 1998 for ASR pilot approval; the Company now expects to make formal application in July. Tr. p. 967; 2) that it would post on its web site in 1998 a general information notice explaining the underlying quality issues regarding iron and manganese — the Company has put the notice together and has distributed it as a bill stuffer; not on web site yet, Tr. p. 968, and 3) that it was preparing a Consumer Confidence Report on overall water quality that it expected would be available by April 1998; the Report is not yet completed. Tr. p. 968.

We find:

We acknowledge the continuing efforts of United Water to reduce the number of customer complaints related to the presence of secondary contaminants (iron and manganese) in its supply waters and to better educate its customers regarding the nature of the problem and potential solutions, including in home measures customers may take themselves. We encourage the Company to continue with its efforts. We note, as the Company and Staff have suggested, in any cost/benefit analysis of mitigation measures there is a point beyond which additional money should not be spent. We also note that it is reasonable for the Company to use its supply waters from problem wells during short-term periods of emergency, when to not do otherwise would result in a curtailment of supply and an inability to fill its reservoirs.

VIII Intervenor Funding

Timely Petitions for Intervenor Funding were filed by Idaho Citizens Coalition and Sharon Ullman. Reference IDAPA 31.01.01.161. United Water on June 4 filed a response and objection to the Petitions for Intervenor Funding. Each petitioner thereupon filed a reply, Ms. Ullman on June 9 and the Idaho Citizens Coalition on June 19.

Citizens Coalition

The Petition of the Idaho Citizens Coalition requesting \$6,955 comports with the requirement of Rule 161 of the Commission's Rules of Procedure. Dr. Power's testimony for the Coalition dealt with three issues: (1) the Boise River diversion, (2) the timing of any approved increase in rates and (3) methods for controlling the ongoing costs associated with the expansion of the water system. The Coalition's positions on each of the issues, it states, differed materially from Staff, which either took no position or different positions on each.

United Water questions the materiality of the Coalition's contribution in this case. The Company, as it did in its repeated Motions to Strike, reiterates its understanding of Order No. 27556, interpreting the Commission's language as a rejection of the Coalition's proposal to defer any change in rates until completion of the rate design and cost of service phase of the Company's rate case. The Company concludes in rather summary fashion that in any event, Dr. Power's proposal runs contrary to clear Idaho law.

The Company challenges Dr. Power's testimony on the Boise River diversion as being largely duplicative of Staff's evaluation, albeit conceding that Dr. Power placed more emphasis on the "extreme emergency" provision of *Idaho Code* § 61-502A. The Company characterizes Dr. Power's testimony as flawed by his "continued insistence that construction of the diversion was a voluntary business decision and his refusal to acknowledge that construction was necessitated by a mandate from government. . . ."

The Company dismisses Dr. Power's discussion of geographically deaveraged rates as a means of addressing growth and the number of customers being served and the location of those customers in places with relatively high costs to serve as a theoretical exercise relating more directly to rate design, and suggests that the Commission consider deferring the Coalition's Intervenor Funding request until the conclusion of that proceeding.

Sharon Ullman

The Petition of Ms. Ullman requesting \$4,696.22 comports with the requirements of Rule 161 of the Commission's Rules of Procedure. Ms. Ullman in this case addressed and challenged the reasonableness of Company salaries and benefits, overhead costs, rate case expense, requested rate of return, the timing of any authorized rate increase, the comparative cost of UWI water with other area water providers, the used and useful standard, ad valorem tax expense, attorney fees, and administrative matters. Ms. Ullman states that the positions she advanced on almost all of the issues addressed were different than those addressed by Commission Staff.

United Water disputes Ms. Ullman's contention that she somehow represents the public or is acting on behalf of United Water's customers and recommends that her request be denied. Authority to represent the public cannot be a process of self-anointment, the Company contends, but must be conferred by those whose interests are purportedly represented. Individual citizens are certainly entitled to express opinions on issues pending before public bodies, the Company states, but in the absence of some delegated authority from others, they do so in their own name.

Ms. Ullman by way of response contends that to the extent her interests are indistinguishable from ratepayers generally, the validity of her representative participation is proved. She reminds the Company and Commission that her full participation in Commission proceedings as an affected customer is encouraged by *Idaho Code* § 61-617A. Ms. Ullman reminds Mr. Miller, the Company's attorney, that when he himself was a member of the Commission, the Commission declared "Ms. Ullman's participation in this case was insightful, well prepared and helpful to this Commission. Her effectiveness and knowledge of an arcane subject were impressive. We appreciate her involvement." Ms. Ullman has participated in numerous United Water (Boise Water) cases, and in the most recent case was granted Intervenor Funding.

We find:

Pursuant to *Idaho Code* § 61-117A, the maximum award of intervenor funding that may be made in any one case is \$25,000. We find that the participation of both the Idaho Citizens Coalition and Ms. Sharon Ullman materially contributed to our decision in this case. The testimony of the Coalition was detailed and well reasoned. The testimony of Ms. Ullman offered a different perspective. The intervenors advanced positions differing materially from those of Staff on issues of concern to all of United Water's customers. We find that it would constitute a significant

financial hardship for the intervenors if they are not awarded funding. We find it reasonable to award the Coalition \$6,955, the full amount requested. Ms. Ullman has requested \$4,696.22. Included within her itemization of expense is 113 hours @ \$40/hour. While Ms. Ullman may feel that the number of hours was reasonable to spend, we find that it exceeds a reasonable level of expense for purpose of intervenor funding. The number of hours we find reasonable are the total consulting/research hours itemized by the Coalition in this case, i.e., 81 hours. Making that adjustment, we authorize an award to Ms. Ullman of \$3,416.22, 81 hours @ \$40/hour, plus copying (\$129.26) and postage (\$46.96).

United Water is instructed to pay these amounts within 28 days from the date of this Order. The Company is further directed that these costs, which we find to be an embedded part of authorized rate case expense, should be amortized over three years.

CONCLUSIONS OF LAW

The Idaho Public Utilities Commission has jurisdiction over United Water Idaho Inc., a water utility, and its Application in Case No. UWI-W-97-6 pursuant to the authority and power granted under Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq.*

ORDER

In consideration of the foregoing and as more particularly described above, IT IS HEREBY ORDERED and the Commission hereby authorizes United Water Idaho Inc. to increase its revenues by \$1,581,989 or approximately 7.15%. The Company is directed to file amended tariff sheets for rates and charges in compliance with the terms of this Order. The rate increase that we authorize is effective for service rendered on and after July 1, 1998.

IT IS FURTHER ORDERED and United Water Idaho Inc is directed to file with the Commission Secretary a separate cost of service and rate design application within thirty (30) days from the date of this Order.

IT IS FURTHER ORDERED and the Commission pursuant to *Idaho Code* § 61-117A grants intervenor funding to the Idaho Citizens Coalition in the amount of \$6,955 and to Ms. Sharon Ullman in the amount of \$4,696.82. United Water Idaho Inc is directed to pay the intervenors within twenty-eight (28) days from the date of this Order.

THIS IS A FINAL ORDER. Any person interested in this Order (or in issues finally decided by this Order) or in interlocutory Orders previously issued in this Case No. UWI-W-97-6 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 or in interlocutory Orders previously issued in this Case No. UWI-W-97-6. 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 ^{July} 6th
day of June 1998.

Dissenting (See Attached)
DENNIS S. HANSEN, PRESIDENT

Ralph Nelson
RALPH NELSON, COMMISSIONER

Marsha H. Smith
MARSHA H. SMITH, COMMISSIONER

ATTEST:

Myrna J. Walters
Myrna J. Walters
Commission Secretary

vld/O:UWI-W-97-6.sw6

DISSENT OF COMMISSIONER DENNIS S. HANSEN
Order No. 27617, Case No. UWI-W-97-6

I disagree with parts of the majority opinion and the amount of revenue increase granted to United Water Idaho Inc.

NORTH STATE ACQUISITION

First, I do not believe that the North State acquisition adjustment of \$577,664 should be included in rate base. The North State/Garden City exchange was a discretionary decision made by the Company and municipal authorities. Tr. p. 517. The Company's investment in Garden City facilities should not be allowed in rate base on the grounds that the purchased plant was previously contributed, i.e., that the assets were originally contributed to public service by developers and or customers at no cost to Garden City.

As pointed out in the testimony of Staff witness Lobb, the revenues generated by the customers within the North State area, are only sufficient to cover the costs associated with the purchase price of the distribution system, \$577,664, and cover operating expenses. With the increase in the customer base (new North State customers minus Millstream customers lost), the revenues generated are sufficient to cover either the investment cost or the source of supply costs. However, I am not convinced that the revenues are sufficient to cover both the costs associated with the acquisition adjustment and the source of supply necessary to provide service to the customers. By allowing this expense, the general body of customers is being asked to subsidize the water supply costs of the North State area. I don't think it is fair that the general body of customers are required to subsidize either United Water Company's investment in Garden City or the water supply costs.

The Company, in Case No. UWI-W-95-2, as noted in our Order No. 26562, made a commitment to hold harmless the Company's other customers from the consequences of the transaction. As noted in the testimony of Staff witness Smith, this transaction accelerates the timing of a new water source and absent a contribution from rates to support source of supply investment imposes a cost subsidy on the Company's other customers. I concur with the language on page 6 of this order expressing the rationale to disallow inclusion of the North State acquisition adjustment. This reasoning provides sufficient evidence to disallow recovery of the acquisition adjustment.

CAPITALIZED CORPORATE OVERHEAD

Another area of concern in this order is the acceptance of capitalized corporate overhead of \$787,735. Given the information provided, there is no basis to know whether these overheads reflect a fair allocation of the costs to United Water Idaho by United Water Resources. The Staff contends that an audit trail was difficult to follow in the records provided by United Water Idaho. Complicating the audit in this case and the reliability of test year data was a mid-test year change by the Company in its accounting and time reporting systems and procedures.

An audit should be conducted before the full amount is granted in rate base. To me, what may appear to be a good corporate decision of United Water Resources, Inc. may not necessarily be the most economical decision for the Idaho operation in isolation. What I am saying is that corporate decisions may produce inter-corporate subsidies among the operating units. Staff identified the Company's vehicle lease program and ramifications of a municipal condemnation of a United Water Resource subsidiary in Rio Rancho, New Mexico as activities that raised flags regarding the affiliated web of companies and the related operating consequences affecting United Water Idaho.

BOISE RIVER INTAKE

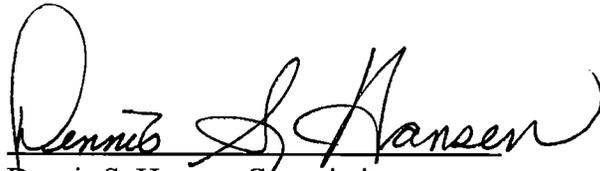
The Boise River intake is another expenditure that should not be included in the general customer's bill. This \$1.9 million expense by the Company is an investment into the future, which the Company says **may** be needed by the year 2005. Recognizing that there is no immediate need for the diversion waters to meet demand now or for several years into the future, I oppose allowing the amortization of the Boise River diversion in expenses paid by customers until it is used and useful. This is a case where the Company has built ahead of its needs. The Company does not even have water rights that would allow it to operate the diversion. This type of future investment without any advance knowledge being given to the Commission, should not be allowed . . . it makes the Commission not obligated in any way.

I do **not** believe the "supposedly" lower cost business opportunity for United Water Idaho constitutes an "extreme emergency." Also, in a letter concerning the project (Exhibit 110), Mr. Carl Ellsworth of the Public Works Department with the City of Boise, states that he was assured by United Water Idaho that they would not include their share of the capital costs of this project in rate base until the project is being fully used.

NORTHWEST PIPELINE

I also disagree with the majority decision allowing United Water Idaho to recover amortization of its investment in the Northwest Pipeline. First, there was no urgency. The deficiency was no greater in 1997 than in past years. Second, with a planned 8MGD Marden treatment plant expansion scheduled to come on line in May 1999, the deficiency is short term. The Company also failed to utilize other supply resources available to it, such as the Swift No. 3 well, Garden City contract supply rights, conservation measures during 1997 peak requirements.

Lengthy distribution pipeline constructed ahead of development places a substantial portion of the cost of new development on the backs of existing ratepayers rather than through developer contributions, as the line extension rules would otherwise require.



Dennis S. Hansen, Commissioner