Office of the Secretary
Service Date
July 10, 1998

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF UNITED WATER IDAHO INC. FOR AUTHORITY TO REVISE AND INCREASE RATES CHARGED FOR WATER SERVICE.

CASE NO. UWI-W-97-6

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 <u>$4,696.82</u>. 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 <u>$3,416.22</u>. 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

Myrna J. Walters - Commission Secretary

bls/O-uwiw976.err

Office of the Secretary
Service Date
July 6, 1998

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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