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

A.My name is Terri Carlock.  My business address is 472 West Washington Street, Boise, Idaho.

Q.By whom are you employed and in what capacity?

A.I am employed by the Idaho Public Utilities Commission as the Accounting Section Supervisor.

Q.Please outline your educational background and experience.

A.I graduated from Boise State University in May 1980, with a B.B.A. Degree in Accounting and in Finance.  I have attended the annual regulatory studies

program sponsored by the National Association of Regulatory Utilities Commissioners (NARUC) at Michigan State University.  I chaired the NARUC Staff Subcommittee on Economics and Finance for over 3 years.  Under this subcommittee, I also chaired the Ad Hoc Committee on Diversification.  I have also attended various finance conferences, including the Public Utilities Finance/Advance Regulation Course at the University of Texas at Dallas, the National Society of Rate of Return Analysts' Financial Forums, the Regulatory Economics and Cost of Capital Conference in Utah, and a Standard & Poor's Corporation Telecommunications Ratings Seminar.  Since joining the Commission Staff in May 1980, I have participated in several audits, performed financial analysis on various companies and have presented testimony before this Commission on numerous occasions.

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

A.The purpose of my testimony is to present the Staff's recommendation related to the overall cost of capital for United Water Idaho, Inc. (United Water Idaho or UWID) to be used in the revenue requirement in this case, UWI-W-97-6.  I will address the appropriate capital structure, cost rates and the overall rate of return.

Q.Please summarize your recommendations.

A.I am recommending a return on common equity in the range of 10.25% - 11.25% with a point estimate of 11.00%.  The recommended overall weighted cost of capital is in the range of 8.56% - 8.96% with a point estimate of 8.86% to be applied to the rate base for the test year.

Q.Are you sponsoring any exhibits to accompany your testimony?

A.Yes, I am sponsoring Exhibit No. 101 consisting of 17 schedules for a total of 20 pages.

Q.Have you reviewed the testimony and exhibits of UWID witness Hanley?

A.Yes.  I generally agree with the theoretical approach Mr. Hanley uses in his testimony and exhibits.  My judgement in some areas would have resulted in different outcomes.  I will discuss some of these differences later in my testimony.

Q.What legal standards have been established for determining a fair and reasonable rate of return?

A.The legal test of a fair rate of return for a utility company was established in the Bluefield Water Works decision of the United States Supreme Court and is repeated specifically in Hope Natural Gas.

In Bluefield Water Works and Improvement Co.  v. West Virginia Public Service Commission, 262 U.S. 679, 692, 43 S.Ct. 675, 67 L.Ed. 1176 (1923), the Supreme Court stated:

A public utility is entitled to such

rates as will permit it to earn a return

on the value of the property which it

employs for the convenience of the

public equal to that generally being

made at the same time and in the same

general part of the country on

investments in other business

undertakings which are attended by

corresponding risks and uncertainties;

but it has no constitutional right to

profits such as are realized or

anticipated in highly profitable

enterprises or speculative ventures.

The return should be reasonably

sufficient to assure confidence in the

financial soundness of the utility and

should be adequate, under efficient and

economical management, to maintain and

support its credit and enable it to

raise the money necessary for the proper

discharge of its public duties.  A rate

of return may be reasonable at one time

and become too high or too low by

changes affecting opportunities for

investment, the money market and

business conditions generally.

The Court stated in FPC v. Hope Natural Gas Company, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944):

From the investor or company point of

view it is important that there be

enough revenue not only for operating

expenses but also for the capital costs

of the business.  These include service

on the debt and dividends on the stock.

... By that standard the return to the

equity owner should be commensurate with

returns on investments in other

enterprises having corresponding risks.

That return, moreover, should be

sufficient to assure confidence in the

financial integrity of the enterprise,

so as to maintain its credit and to

attract capital.  (Citations omitted.)

The Supreme Court decisions in Bluefield Water Works and Hope Natural Gas have been affirmed in In re Permian Basin Area Rate Case, 390 U.S. 747, 88 S.Ct 1344, 20 L.Ed 2d 312 (1968), and Duquesne Light Co. v. Barasch, 488 U. S. 299, 109 S.Ct. 609, 102 L.Ed.2d. 646 (1989).  The Idaho Supreme Court has also adopted the principles established in Bluefield Water Works and Hope Natural Gas.  See In re Mountain States Tel. & Tel. Co. 76 Idaho 474, 284 P.2d 681 (1955); Hayden Pines Water Company v. IPUC, 122 ID 356, 834 P.2d 873 (1992); General Telephone Co. v. IPUC, 109 Idaho 942, 712 P.2d 643 (1986).

As a result of these United States and Idaho Supreme Court decisions, three standards have evolved for determining a fair and reasonable rate of return:

(1) the Financial Integrity or Credit Maintenance Standard; (2) the Capital Attraction Standard; and, (3) the Comparable Earnings Standard.  If the Comparable Earnings Standard is met, the Financial Integrity or Credit Maintenance Standard and the Capital Attraction Standard will also be met, as they are an integral part of the Comparable Earnings Standard.

Q.Have you considered these standards in your recommendation?

A.Yes.  These criteria have been seriously considered in the analysis upon which my recommendations are based.  It is also important to recognize that the fair rate of return that allows the utility company to maintain its financial integrity and to attract capital is established assuming efficient and economic management, as specified by the Supreme Court in Bluefield Water Works.

Q.Please summarize the parent/subsidiary relationships for United Water Idaho.

A.United Water Idaho's common stock is not traded.  It is wholly-owned by United Waterworks (UWW), which is wholly-owned by United Water Resources (UWR).  Due to this parent/subsidiary relationship there is no direct market data available on United Water Idaho.  The only stock market information available to utilize in determining the cost of equity capital is for United Water Resources.

Q.What approach have you used to determine the cost of equity for UWID specifically?

A.I have presented two methods:  the Discounted Cash Flow (DCF) method and the Comparable Earnings method for industrials and utilities.  I have also utilized witness Hanley’s exhibits and made the judgmental changes I believe are more appropriate.

Q.Please explain the Comparable Earnings method and how the cost of equity is determined using this approach.

A.The Comparable Earnings method for determining the cost of equity is based upon the premise that a given investment should earn its opportunity costs.  In competitive markets, if the return earned by a firm is not equal to the return being earned on other investments of similar risk, the flow of funds will be toward those investments earning the higher returns.  Therefore, for a utility to be competitive in the financial markets, it should be allowed to earn a return on equity equal to the average return earned by other firms of similar risk.  The Comparable Earnings approach is supported by the Bluefield Water Works and Hope Natural Gas decisions as a basis for determining those average returns.

I have analyzed the returns for utilities

and industrials in order to determine a fair return for UWID.  When determining the comparable earnings rate, it is important that a cross-section of various companies and industries be utilized in the sample so that any possible effects of unusual occurrences or monopoly powers are limited.  It is also important that any risk differentials between the comparable earnings sample and UWID be resolved.

In my comparable earnings analysis, the rates of return on common equity historically earned by industrial firms were examined.  The historical returns earned by electric and gas utilities were also studied.  Current returns for water companies, interest rates and bond yields were also examined.  Then, based upon current economic conditions, the current cost of equity capital for industrial firms on the average was estimated.  Taking into consideration the risk differentials between industrials and utilities and those differentials as they specifically relate to UWID, I estimated the current cost of equity range utilizing the Comparable Earnings approach.

Q.Please explain your schedules reflecting the historical rate of return earned for industrial firms.

A.Schedules 1 through 4 of Exhibit No. 101 show the returns on common equity for the Business Week Corporate Scoreboard over the last ten years.

Industrial returns tend to fluctuate with business cycles, increasing as the economy improves and decreasing as the economy declines.  I have utilized a three-year moving average to smooth the business cycle effects and yearly fluctuations in the industrial rate of return.  Utility returns are not as sensitive to fluctuations in the business cycle because the demand for utility services generally tends to be more stable and predictable.  Schedule 1 reflects the returns earned for periods ending the First Quarter of each year; Schedule 2 reflects the returns for periods ending the Second Quarter; Schedule 3 reflects the returns for periods ending the Third Quarter; and Schedule 4 reflects the returns for periods ending the Fourth Quarter of each year.  Slower economic conditions are reflected in the yearly return fluctuations.  The effects of economic recovery may not immediately show up in the overall industry results.

For years ending the First Quarter

(Schedule 1 of Exhibit No. 101), the five-year average return from 1992 through 1996 was 13.2%, and the five-year average from 1993 through 1997 was 14.9%.  The three-year moving average for 1997 of 16.9% is greater than the three-year moving average of 15.2% in 1996 reflecting higher Industrial Composite returns.

For years ending the Second Quarter

(Schedule 2 of Exhibit No. 101), the five-year average of 15.0% for 1997 is greater than the five-year average of 13.6% for 1996.  The three-year moving average increases from 15.6% in 1996 to 16.7% in 1997.

For years ending the Third Quarter

(Schedule 3 of Exhibit No. 101), the five-year average from 1993 through 1997 was 15.3%, increasing from 13.9% in 1996.  The three-year moving average from 1995 through 1997 was 16.6%, reflecting an increase from 15.8% in 1996.

For years ending the Fourth Quarter

(Schedule 4 of Exhibit No. 101) the five-year average return of 15.5% for 1997 is an increase from 14.2%

in 1996.  The three-year average in 1997 of 16.5% is up slightly from the 16.3% in 1996.

These statistics show the decrease and increase in average industrial returns as a result of economic conditions.  The fourth quarter utility composite of 10.1% in 1997 is lower than the 11.4%

in 1996 and the 11.5% in 1995.

Schedule 5 of Exhibit No. 101 depicts the returns for the years ending each quarter from 1988 through 1997 for the Corporate Scoreboard composite return, the three-year moving average industrial return and the utilities return as reflected in Schedules 1 through 4.  This graph shows the increase and decrease of industrial returns and the utility composite return through various business cycles.

Q.What is your estimate of the current and near-future equity returns for industrial companies?

A.Based upon the three-year moving average trend in industrial earnings and actual earnings

since 1994, (Schedules 1 through 5, Exhibit No. 101) along with current economic conditions, I believe industrial returns will stabilize through 1999.

The 1997 inflation rate is 1.7% for the consumer price index and -1.2% for the producer price index.  The change in the inflation rate can be seen by looking at the consumer and producer price indexes as shown in Schedule 6 of Exhibit No. 101.  The change in bond rates is illustrated in Schedule 7 of Exhibit

No. 101, Moody's Average for Public Utility Bond Yields.  The yields are shown for "Aa", "A" and "Baa" bonds from 1977 through January 1998.  Prime interest rates as shown in Schedule 8 of Exhibit No. 101 have been at 8.25% - 8.50% since 1995.

The Dow Jones Industrial Average Index (DJIA) has fluctuated widely between the August 12, 1982 low of 776.92 to a closing record on March 3, 1998

of 8584.83.  The Dow Jones Utility Average (DJUA) reached a record high of 272.47 on March 3, 1998.

I reviewed the actual earned returns on equity for industrials, the decline and improvement in the economy, changing inflation and stock market conditions.  Based upon these considerations my estimate of the near future equity capital returns for industrials is in the range of 16.0% - 17.0%.

Q.How does the trend in utility returns compare with the trend in industrial returns?

A.Schedule 5 of Exhibit No. 101 shows in graph form the more stable utility returns.  Schedule 9 shows the returns for the Moody's Electric Utilities

since 1970.  The returns in individual years may increase or decrease from the prior year, but the three-year moving averages show general movements in earned returns.  The three-year moving average electric utility returns have not been above 12.0% since 1987.  The annual return through September 1997 of 11.1% is consistent with each of the 3-year, 5-year and 10-year average returns.

The return on common equity for the Moody's Gas Distribution Companies is shown in Schedule 10 of Exhibit No. 101.  The actual return in 1996 of 15.5% is higher than other years thus appearing to be an aberration that may not continue.  The lower 11.8% for the twelve months ended September 1997 supports this notion.  Based on the averages, I expect the average gas return will most likely be in the 12.0% to 13.0% range.

The return on common equity for water utilities is shown on Schedule 11 of Exhibit No. 101.  The average return on common equity for the 12-month period ending September 30, 1997 is 10.8%.  The average return for the group excluding United Water Resources, Inc. is 11.0%.

A review of electric and gas utility returns provides a record of actual utility returns earned in the past.  The water utility average provides a water industry specific comparison.  The required return for water utilities, and United Water Idaho specifically, can then be estimated by reviewing current market changes and considering any risk differentials between the different types of utilities.

Q.Please explain the risk differentials between industrials and utilities.

A.Risk is a degree of uncertainty relative to a company.  The lower risk level associated with utilities is attributable to many factors.  Utilities continue to have limited competition for distribution of utility services within the certificated area.  With limited competition for regulated services, there is less chance of losses related to pricing practices, marketing strategy and advertising policies.  The competitive risks for gas, electric and telecommunication utilities have changed with increasing non-utility generation, open transmission access, and implementing the Tele- communications Act of 1996.  Competitive risks are limited for United Water.  Smaller water companies that have certificated areas near areas served by United Water produce little competition for United Water.  In fact, United Water has evaluated the purchase of many of these systems.  The investments required and the costs resulting from the Safe Drinking Water Act produce some investment risk.  Currently these investment risks for United Water Idaho are fairly low since the current costs are included in rates.  This risk may increase again in the future.  This investment risk is one type of risk but it does not make water utilities more risky than other utilities.  The demand for water utility services is relatively stable and certain compared to that of unregulated firms and even other utility industries.

Under regulation, utilities are generally

allowed to recover, through rates, reasonable, prudent and justifiable cost expenditures related to regulated services.  Unregulated firms have no such assurance.  Utilities in general are sheltered by regulation for cost recovery risks, making the average utility less risky than the average unregulated industrial firm.

Q.Have you compared United Water directly with other utility companies?

A.United Water Idaho's common stock is currently 100% owned by United Waterworks, which

is 100% owned by United Water Resources, Inc.  In my comparisons I used the market data for UWR because neither UWID nor UWW have common stock outstanding in the market.

Schedule 11 of Exhibit No. 101 shows the 10.8% average return for water companies and the 11.0% average when UWR is excluded.  On Schedule 12 of Exhibit No. 101, I have compared this water company average and financial statistics for UWR with other companies that meet the following Value Line Investment Survey criteria:

1.  Beta of .50 - .60 where the market

equals 1.00 (UWR’s Beta is .55);

2.  Safety of 3 where 1 is the highest rating and 3 is average (UWR's safety rating is 3); and

3.  Timeliness of 3 again where 1 is the highest rating and 3 is average (UWR's timeliness rating is 3).

The companies meeting all three criteria are shown on Schedule 12, pages 2 and 3 of Exhibit No. 101.  The group of companies have Betas of .50 through .60 reflecting risk similar to UWR with a Beta of .55.  The summary financial statistic comparisons are reflected on page 1 of Exhibit No. 101, Schedule 12.  The statistics shown include average annual price/earnings ratio, average annual dividend yield, common equity ratio, percent earned on common equity, percent payout ratio and market to book ratio. The sample group average earned return on equity is 11.5%.

Q.Based upon your analysis of industrial returns, utility returns, and current economic conditions, what is your estimate of the cost of equity capital for UWR, and ultimately United Water Idaho, based upon the Comparable Earnings method?

A.When utilizing the Comparable Earnings method, the risk differentials between industrials and utilities, particularly United Water Idaho and UWR, must be considered.  Utility returns, in comparison to industrial returns, may be ranked by classifying the utility services according to risk levels.  Utility groups are less risky than industrials and water utilities continue to be the least risky.  Because an average utility company is less risky than an average industrial company, its cost of equity capital range would be less.  Water companies, including UWR and UWID, are less risky than an average utility company so the cost of equity capital would be less than that of both an average utility and that of an average industrial company.  When considering the risk differentials between water utilities and other companies, capital requirements to meet the standards under the Safe Drinking Water Act are a concern.  Under current standards, UWID has made investments to meet the required standards.  Therefore, the investment risks to UWID due to the Safe Drinking Water Act are minimized currently but additional investments are expected to increase again in the future.

Using the Comparable Earnings approach, my estimate of the current cost of equity capital for UWID is in the range of 10.5% - 11.5%.  This range is developed by reviewing the most recent industrial returns and the expected industrial return range of 16% - 17% adjusted for the risk differential (Beta of .55 for UWR) results in a risk adjusted range of 8.8% - 9.4%.  The utility returns as shown in the Corporate Scoreboard of 11.2% for the First Quarter of 1997, 10.7% for the Second Quarter of 1997, 10.7% for the Third Quarter of 1997 and, 10.1% for the Fourth Quarter of 1997 (Ex. 101, Sch. 1-4, respectively); three-year average returns of 12% ending 1996 and 11.1% for the twelve months ending September 1997 for the Moody's Electric Utilities (Ex. 101, Sch. 9); and three-year average returns of 13.6% ending 1996

and 11.8% for the twelve months ending September 1997 for the Moody's Gas Distribution Utilities (Ex. 101, Sch. 10).  These returns are then analyzed along with the 11% average water utility returns shown on Ex. 101, Sch. 11, the comparable earnings shown on page 1 of Schedule 12, the market indicators (Schedules 6 - 8 of Ex. 101) and the industrial returns (Schedules 1 - 5 of Ex. 101) to predict a reasonable required return.

Q.You indicated that the Discounted Cash Flow method is utilized in your analysis.  Please explain this method.

A.The Discounted Cash Flow (DCF) method is based upon the theory that (1) stocks are bought for the income they provide (i.e., both dividends and/or gains from the sale of the stock), and (2) the market price of stocks equals the discounted value of all future incomes.  The discount rate, or cost of equity, equates the present value of the stream of income to the current market price of the stock.  The formula to accomplish this goal is:

           D1         D2           DN        PN

Po = PV = ------- + ------- +...+ ------ + ------

         (1+ks)1    (l+ks)2       (1+ks)N   (1+ks)N

Po =Current Price

D =Dividend

ks =Capitalization Rate, Discount Rate, or Required Rate of Return

N =Latest Year Considered

The pattern of the future income stream is the key factor that must be estimated in this approach.  Some simplifying assumptions for ratemaking purposes can be made without sacrificing the validity of the results.  Two such assumptions are:  (1) dividends per share grow at a constant rate in perpetuity; and, (2) prices track earnings.  These assumptions lead to the simplified DCF formula, where the required return is the dividend yield plus the growth rate (g):

       D

            ks = -- + g

       Po

Q.What is your estimate of the current cost of

capital for the Company using the Discounted Cash Flow

method?

A.The current cost of equity capital for UWR and thus UWID, using the Discounted Cash Flow method is between 8.5% - 10.7% during various time intervals over a 52-week range, as shown on Schedule 13, page 1 of Exhibit No. 101.  I believe the three-month average price (November 18, 1997 - February 17, 1998) is the most appropriate average time interval to use.  This average price reflects current investor expectations without being subject to daily market fluctuations, as could be the case if the price on a specific date were used.  The average price results in the 8.8% to 9.8% range. The price of $19.125 on March 4, 1998 results in a DCF return of 8.7% to 9.7%.  This is not significantly different from the DCF return using the average price to make it unreasonable.  Therefore, I have used the 8.7% to 9.7% range to coincide with the growth rate that more heavily reflects growth projections as the most appropriate estimate under the Discounted Cash Flow method for use in this case.

Q.How is the growth rate (g) determined?

A.The growth rate is the factor that requires the most extensive analysis in the DCF method.  It is important that the growth rate used in the model be consistent with the dividend yield so that investor expectations are accurately reflected and the growth rate is not too large or too small.

I have used an expected growth rate

of 3.5% - 4.5%.  This expected growth rate was derived from an analysis of various historical and projected growth indicators, including growth in earnings per share, growth in cash dividends per share, growth in book value per share and the sustainable growth for UWR (Exhibit No. 101, Schedule 13, page 2).

A review of these growth indicators shows the five-year growth rate through 1997 in earnings per share of negative 2.5% and the five-year average growth in cash dividends per share of .5%.  These average growth rates are not projected to continue.  The Value-Line projected growth rates for 2000-2002 are 8.0% for earnings, 1.5% for dividends, and 3.5% for book value. I have used a 3.5% - 4.5% growth rate to reflect the growth potential over a longer term.

Q.You have utilized an adjusted dividend yield to determine the required return with the DCF method.  Please explain.

A.The adjustments I have made to arrive at the adjusted dividend yield for the DCF method recognize the quarterly compounding of dividends, growth and direct issuance or flotation costs for stock issuances.  Although market pressure should not be reflected in the flotation cost adjustment, I have used a 2% flotation cost rate as a reasonable flotation cost over time to be included in the DCF analysis.  The adjusted formula and results are shown on Exhibit No. 101, Schedule 13,

page 1.

Q.Please explain the quarterly compounding of dividends.

A.The Commission allowed for compounding of dividends in Order No. 23420, Case No. BOI-W-90-1.  As in BOI-W-93-1, I have adjusted the dividend yield in this case to reflect the impact of quarterly dividend compounding.  To properly compound for the quarterly payment of dividends, the adjustment is appropriately made to the dividend rate.  This annual dividend rate, compounded for quarterly payments, is used to calculate the dividend yield and required return in the DCF method.  Exhibit 101, Schedule 13, page 1 shows the quarterly dividend payment of $.23 compounded at 3.5% - 4.5% growth for four quarterly dividend payments, or $.97 annually.

Although it is true that dividends are paid quarterly and not annually, I do not believe that the quarterly adjustment is necessary for the DCF method.  The quarterly adjustment I made increases the DCF return by approximately .2%.  Quarterly DCF models basically compound the dividend yield for timing differences of quarterly payments then add the incremental growth rate.  The compounded yield assumes that the company is responsible for reinvestment payments the investor will receive by reinvesting his/her dividends.  The investor has the option to reinvest the dividends in UWR stock or in some other security.

Q.Please explain the adjustment to reflect

a 2.0% issuance expense or flotation cost factor to calculate the dividend yield in the DCF calculation?

A.The 2.0% is based on the recent issuance expenses incurred.  Issuance costs are relevant expenditures to consider in the cost of equity determination for new issuances.  Direct issuance or flotation costs impact the actual price received by the company for stock sold.  The funds received amount to the stock price less the issuance costs.  To reflect these costs, the dividend yield is adjusted in the DCF method.

A specific allowance for market pressure is not appropriate.  Investors determine the price they are willing to pay for stock at the time of issuance.  I do not believe it is appropriate to make an allowance for price fluctuations as a result of this competitive process.  I have used the 2% allowance as reasonable over time.

Q.You indicated previously that you agreed with the basic theories used by UWID witness Hanley but that you would make different judgement calls in some areas.  Please expand on the differences you would utilize.

A.The main difference relates to Mr. Hanley’s judgement on what return figures are not meaningful.  I believe that all returns are meaningful.  However, some returns are discounted in importance by investors or analysts.  This difference may seem like semantics but I believe the full range of returns identified in Mr. Hanley’s exhibits are relevant.  Exhibit No. 101, Schedule 14 is a recap of Mr. Hanley’s Exhibit No. 12, Schedule 1, page 2 reflecting all of the results and adding a column to reflect United Water Resources.  The UWR column is derived from the basic information included in Mr. Hanley’s exhibits for each method.

I do not believe a business risk adjustment is required as shown in Mr. Hanley’s exhibit.  However, if a maximum adjustment of .2 is reflected this would produce the upper end of a range of reasonableness.  The cost of equity recommendation using Exhibit No. 12, Schedule 14 is in the range of 10.2% - 11.4%.  This overlaps the ultimate 10.25% - 11.25% range of reasonableness that I have recommended.

Q.What is the capital structure you have used for United Water Idaho to determine the overall cost of capital?

A.I have utilized a hypothetical capital structure consisting of 52% debt, 8% minority interest or preferred equity and 40% common equity as shown on Schedule 17 of Exhibit No. 101.  Company witness Hanley utilizes a June 30, 1997 capital structure for United Water Idaho.  This capital structure consists of 53.13% long-term debt, .14% minority interest and 46.73% common equity.

Q.Please explain why the hypothetical capital structure you recommend is reasonable.

A.The hypothetical capital structure I am recommending is appropriate to use for ratemaking purposes in this case.  United Water Idaho does not directly raise funds in the markets.  The debt funds are issued at the United Waterworks level and the equity funds are retained through earnings or raised at the United Water Resources level.  Therefore, the actual capital structure shown on the books of United Water Idaho has been provided by and supported by one of the parent entities.  The UWID capital structure should be double leveraged to reflect this relationship.  Rather than double leverage the capital structure, I believe a hypothetical capital structure is more appropriate.

The hypothetical capital structure is consistent with or better than the actual and estimated capital structures for United Water Resources or the Value Line Water Utility Industry.  The capital structure for UWR is estimated for 1998 to be 52.5% long-term debt, 8.5% preferred stock, 38% common equity and 1% current maturities.  The projected capital structure through the years 2000-2002 is 51% long-term debt and 40% common equity.  The actual and projected common equity ratios show an increasing trend.  The Value Line Water Utility Industry shows an average 40% common equity ratio for 1998.  The 40% common equity ratio I have utilized in the hypothetical capital structure on Exhibit No. 101, Schedule 17 is consistent with the UWR trend and the water utility industry average.  The hypothetical debt ratio of 52% is less than the current debt ratio for UWR of 52.5% 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 No. 101, Schedule 15 also reflects these comparisons.  The 8% minority interest in the hypothetical capital structure is consistant with the 8.5% preferred stock held by UWR.

Q.What are the costs related to the capital

structure for debt and the minority interest?

A.The cost of debt is 7.8% when adjusted for the debt refinancings in January and February of 1998. The cost of minority interest is 5.0%.  I have utilized the methodology used by UWID in its exhibits to calculate the cost of debt as shown on Schedule 16, Exhibit

No. 101.

In BOI-W-93-1 and BOI-W-93-3, I expressed concern that several long-term debt issues outstanding were at rates high enough to warrant refinancings.  United Water has refinanced two of the high cost notes at more favorable rates.  The 7.8% cost of debt reflects these refinancings.  United Water states its policy is to periodically review the feasibility of refinancing other issues.  However, many of the issues have call provisions making these issues expensive to refinance.

Q.You indicated the cost of common equity range for United Water Idaho is 10.5% - 11.5% under the Comparable Earnings method and 8.7% - 9.7% under the Discounted Cash Flow method.  What is the cost of common equity capital you are recommending?

A.The fair and reasonable cost of common equity capital I am recommending for United Water Idaho is in the range of 10.25% - 11.25%.  This also falls within the range reflected in my recap of Mr. Hanley’s exhibit as shown on Exhibit No. 101, Schedule 14 with a range of 10.2% - 11.4%.  Although any point within the range of 10.25% - 11.25% is reasonable, the return on equity granted would not normally be at either extreme of the fair and reasonable range.  I utilized a point estimate of 11%, in calculating the overall rate of return for the revenue requirement.

Q.What is the basis for your point estimate being 11% when your range is 10.25% - 11.25%?

A.The 11% return on equity point estimate utilized is based on:  (1) a review of the market data and comparables shown on the schedules in Exhibit

No. 101; (2) UWR stock price shown on Exhibit No. 101, Schedule 13, (3) average risk characteristics for UWID, (4) average customer relations, and (5) the recommended hypothetical capital structure.  If the hypothetical capital structure is not utilized, I would recommend the 10.75% midpoint as the reasonable return on equity point within the range.

Q.What is the overall weighted cost of capital you are recommending for United Water Idaho?

A.I am recommending an overall weighted cost of capital in the range of 8.56% - 8.96% as shown on Schedule 17, Exhibit No. 101.  For use in calculating the revenue requirement, a point estimate consisting of a return on equity of 11% and a resulting overall rate of return of 8.86% was utilized.

Q.Does this conclude your direct testimony in this proceeding?

A.Yes, it does.