BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

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| 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  REPLY BRIEF OF COMMISSION STAFF RELATING TO CAPITAL STRUCTURE |

COMES  NOW  the Commission Staff in Case No. UWI-W-97-6 and tenders to the Commission for its consideration the following post-hearing Reply Brief on Capital Structure.

The Company states that Staff witness Carlock’s hypothetical capital structure is essentially the same as utilizing double leveraging.  They imply that double leveraging concepts have been utilized to support the Staff’s hypothetical capital structure.  This is simply not true.  The double-leveraged capital structure for United Water Idaho would consist of 19.95% common equity, 4.82% preferred stock, and 75.23% debt as shown on Attachment A.

In the Company Brief page 6, Item No. 10, the “Standard and Poor’s total debt to total capital criterion for a water company in an average business position to obtain and maintain a “A” bond rating is 52%.”  The Standard and Poor’s business profile for United Water Resources and United Water Works is a “3” as shown on Exhibit No. 13, Schedule 1, page 2 of 2.  The Standard and Poor’s utilities rating services financial benchmarks for water utilities Exhibit No. 13, Schedule 7, page 3  is attached as Attachment B.  As shown on this Attachment, the total debt/total capital percentage for an “A” rated utility with a business position of “3” is 53%.  The recommended debt ratio in Staff’s hypothetical capital structure is 52% debt.  The Staff’s hypothetical debt ratio of 52% is consistent with an “A” rated company with a “4” or high average business position.  United Water Resources and United Water Works have a “3” average business position which is one “notch” above the rating that would be established using a 52% debt ratio.  The Company implies that an equity ratio of 48% is required under these benchmarks compared to the 40% equity ratio recommended by Staff.  The 48% ratio is a total equity ratio that is comparable to the total equity (preferred and common equity) ratio of 48% in the Staff’s hypothetical capital structure.

The Idaho Commission has adopted an imputed capital structure or a hypothetical capital structure for various utilities including Pacific Power and Light, Citizens Utilities, and Utah Power and Light, along with United Water Idaho (formerly Boise Water).  The Commission has also adopted double leveraged capital structures for GTE of the Northwest and U S WEST Communications, Inc. (formerly Mt. Bell).  A double leveraged capital structure is not necessarily the same as an imputed or hypothetical capital structure.  In this case, UWI-W-97-6, they are not the same as reflected in Attachment A and compared to the Staff’s recommended hypothetical capital structure of 52% debt, 8% preferred stock or minority interest, and 40% common equity.

The adoption of the Staff’s hypothetical capital structure with 52% debt will not result in a bond downgrading that could ultimately increase the debt cost to the Company and consumers.  Without a potential downgrading the hypothetical capital structure is neither improper nor confiscatory.  The function of the Commission is regulatory and not managerial in nature.  The management is free to determine its own debt/equity ratio even when the Commission adopts a hypothetical capital structure for ratemaking purposes.

The hypothetical capital structure utilized by Staff is consistent with the water utility industry average as portrayed by Value Line.  This industry average reflects the water utility industry and is not based on size of the utility.  Differentials due to size and ultimate risk of the utility should be reflected in the cost of common equity when a point within the reasonable return on equity range is chosen.

If the Commission adopts the capital structure recommended by United Water, the return on equity should be adjusted from that recommended by Staff witness Carlock.  There is less risk inherent in the capital structure proposed by United Water than in the capital structure proposed by Staff.  Lower risk should be reflected by a lower allowed return on equity.

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UNITED WATER

Calculation of Double Leveraged

Capital Structure

UWIDUWWxUWR Consolidated=Double Leveraged

Common EquityCE54.98%CE36.29%CE19.95%

Virtually 100%PS.14%PS8.51%PS UWR4.68%

Debt44.88%Debt55.20%Debt UWR30.35%

PS UWW.14%

Debt UWR44.88%

100.00%100.00%100.00%

Double Leveraged Combined Ratios

CE19.95%

PS4.82%

Debt75.23%