MEMORANDUM

TO:COMMISSIONER HANSEN

COMMISSIONER NELSON

COMMISSIONER SMITH

FROM:SCOTT WOODBURY

DATE:JUNE 16, 1998

RE:CASE NO. UWI-W-97-6

CALCULATION OF RATE BASE

United Water Idaho in its Application proposed an adjusted rate base (2/28/98) 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 the following Staff proposed adjustments:

●Eliminate equity gross-up AFUDC ($54,753)

●Retire Data Point computer equipment($ 5,021)

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

The following proposed adjustments remain disputed:

|  |  |  |
| --- | --- | --- |
|  |  | UWI request |
| ●Eliminate North State acquisition adjustment●Eliminate N.W. Pipeline ●Eliminate portion Island Woods●Eliminate portion Redwood Creek●Eliminate three years capitalized corporate overhead●Eliminate Boise River diversion (Intervenors)●Add book value one vehicle (Co Rebuttal)●Transportation adjustment for leased vehicles  | ($577,664)($940,000)($ 73,400)($824,250)($787,735)($1,882,531)($      3,500)($ 12,505) | $577,664$940,000$260,751$890,269$1,882,531 |

Also undisputed as being used and useful, is the proposed rate basing of the Pierce Park/Gary Lane main installation—$252,937.  This project was previously disallowed in Case Nos. BOI-W-93-1 and BOI-W-93-3.  Tr. pp. 43-48.  The Company by prior Commission Order was directed to enter into a special facilities contract as a way of financing the line extension.  The Company did not do so and 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 was connected in 1995 to the Hidden Hollow Reservoir on Seaman’s Gulch and 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.

North State/Garden City Exchange ($577,664)

The facility and customer exchange between Garden City and United Water was approved in Case No. UWI-W-95-2.  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 on the grounds that the purchase plant was previously contributed, i.e., that the assets were originally contributed to public service by developers and/or customers.  Reference Presumption of Contributed Capital, IDAPA 31.36.01.103.  Tr. pp. 516, 613.  Were the Garden City system 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 adopted by the Commission  and which require 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 access costs be recorded as an acquisition adjustment on the books of the purchasing utility.  Inclusion of same in rate base would be usually 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 transaction consequences, 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 contends that proper analysis demonstrates that North State revenue supports the exchange and any related additional investment.  Tr. pp. 869, 870.  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.  In the spirit of the Commission’s orders (Order Nos. 26562; 26646), the Company argues that if the Commission’s intent was to eliminate the investment it could [and should] have done so in 95-2.  Had the Commission done so, the Company states, it would have terminated the trade.  Tr. p. 870.

Staff analysis (Exhibit 105) demonstrates that North State revenue support Company investment in the Garden City exchange of $583,164.  The Company contends that Staff used the wrong customer count and disputes Staff’s contention that North State revenues support very little expense or investment for water supply needed to serve the North State area (estimated 1 MGD peak demand—Tr. p. 615).  Tr. pp. 614, 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 specifies 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 would support a water supply capital investment of approximately $187,000 (compare estimated $300,000  cost of new well; also $700,000/MGD estimated ($7.8 million) ) cost of supply chosen by UWI in this case—Floating Feather/Redwood Creek/northwest pipeline.  Tr. pp. 616,617.

The Company contends that 34 additional customers have been added to the acquired 893 (??)  bringing the customer count to 927, calculating a total revenue supported investment of $1,568,000.  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.

Northwest Pipeline ($940,000)

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 6 million gallons per day, 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.  Prior test drilling in 1997 to locate a new water supply in the State Street Area, the Company states, resulted in the discovery that both the water quantity and quality necessary to serve its 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 was therefore it states, 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 pipeline was not needed, that the deficiency was no greater in 1997 than in past years (Exhibit 107; Tr. p. 618), that the deficiency is temporary in time with the planned 8 MGD Marden treatment plant expansion scheduled to come on line in May 1999 (Tr. pp. 630, 826-828);  that the Company failed to utilize during 1997 peak requirements other supply resources available to it (wells with aesthetic, iron & manganese) water quality problems: Swift No. 1(1.4 MGD) and Bali Hi (2.67 MGD) Tr. p. 813); Garden City supply contract rights (Tr. pp. 819-824); supply from other service levels (Tr. p. 621).  Other wells completed since 1997 are now available—27th Street Well 0.50 MGD ( Tr. pp. 653, 819).  Less costly supplies, Staff contends, could have been constructed (new wells for approximately $300,000/MGD—Tr. p. 617).  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).  Nor did the Company seriously consider bridging the short-term supply deficit with conservation, i.e., alternate day sprinkling.  Tr. pp. 809, 810, 959, 960.  Furthermore, Staff contends 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 developers, as the rules require.  Tr. pp. 620, 678, 679.

Unrelated and coincident to the need for new supply in the main service level, Staff notes that the 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 (an EM² affiliate operation) 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, are justification for making existing customers pay for the project through rates.  Tr. p. 622.

United Water by way of rebuttal introduced Exhibit 31 to show supply and design constraints in the Boise 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 further 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 (1.44 mgd) should not have been listed by the Company as a source of supply in the main service level west of 36th Street.  Reference Staff Production Request 22.  It should instead, it states, 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.  It is the Company’s plan to use Swift No. 1 as an aquifer storage and recovery project.  Tr. p. 817.

Island Woods ($73,400)

Service to Island Woods was authorized by the Commission and the Company’s Eagle area certificate case.  Reference Case No.EUW-W-94-1.  Island Woods is an independent water system that is not connected to the Company’s larger distribution system.  Tr. p. 43.  As reported by the Company, although the original developer cost of supply and distribution for Island Woods was $334,477 and $225,198, respectively, United Water paid only $276,150 and $103,850.  Tr. p. 42.  The source capacity in Island Woods is 2.6 million gallons per day or 1,800 gallons per minute.  Current 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 62% of its supply investment with the remainder being placed in plant held for future use.  Tr. p. 43.  The Company also proposes including its entire investment in distribution in rate base, noting that with 81 customers in September 1997 the Line Extension Rule in effect at that time would have supported investment of $113,400.

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, which is not challenged by the Company, 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 its entire requested investment can be justifiably rate based.  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.

Redwood Creek/Floating Feather ($824,250)

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.

Staff again utilizing its investment model (Exhibit 104) and Company derived input (27 customers; $457 annual revenue per customer), determined that of the $890,269 investment requested for 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 ($940,000) 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.  (See discussion northwest pipeline).

Capitalized Corporate Overhead ($787,735)

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.

Boise River Intake ($1,882,531)

The Boise River intake project is 2900 feet of 30 inch discharge main through the Surprise Valley Canyon wall cut for Highway 21.  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, although lacking adequate ground water and designated a Ground Water Management Area is a targeted significant growth area (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 (compare UWI system wide annual customer growth 3.1% 1990-1996).  Tr. pp. 25-31.

The Company to meet future demand in southeast Boise 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. Simpott 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 (re: road bed integrity) and (5) its obligation to serve.  Tr. pp. 35-38.

The Company states that it saw no other viable alternative for 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 only those portions of the work have been constructed which could not be delayed until the treatment plant is built—no pumps, electrical equipment or other mechanical equipment have been installed.  Tr. pp. 37, 38.

Except upon its finding of an “extreme emergency” the Commission is prohibited under Idaho Code 61-502A from setting rates for any utility that grants a return on construction work in progress (CWIP) or property held for future use and 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”, i.e., that it was “undertaken in response to a mandate from government to either install the facilities now or be precluded from ever installing them.”  (No explicit written documentation regarding same—Tr. pp. 658, 973).  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.  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 Company notes that the length of time to develop a new source of supply is two years for a well and five to seven years for surface supply.  The Company maintains that it is reasonable that existing customers share in the cost of planning and development.  Tr. pp. 880, 881, 948.

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.  Contending that there was only a narrow window of opportunity, 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.

See Staff opinion re “if the Commission finds that river diversion was a prudent investment at this time but should not be allowed in rates, AFUDC should continue.  Tr. p. 668.

Transportation Adjustment for Leased Vehicles ($12,505)

Staff proposed adjustment makes a correction for a change in the Company’s plans for replacing a vehicle and eliminates 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 unequivocably 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 United Water operates in (most recently Deleware and Pennsylvania).  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 have extremely hard service lives.  Tr. p. 1010.

Restore Book Value One Vehicle to Rate Base ($3,500) Reference Exhibit 20 Column D

Scott Woodbury

vld/M:UWI-W-97-6.sw8