MEMORANDUM

TO:COMMISSIONER HANSEN

COMMISSIONER NELSON

COMMISSIONER SMITH

FROM:SCOTT WOODBURY

DATE:JUNE 16, 1998

RE:CASE NO. UWI-W-97-6

RESULTS OF OPERATION—EXPENSE ADJUSTMENTS

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

United Water Idaho is one of approximately 82 operating units, both utility and non utility, operating in 14 U.S. states, Mexico, Canada and the United Kingdom.  Exhibit 116.  The interaffiliate transactions, Staff contends, present an audit trail that is difficult to follow from UWI records.  Tr. pp. 509, 510.  Complicating the audit in this case and the reliability of test year data, Staff contends, was a mid test year change by the Company in its accounting and time reporting systems and procedures.  Tr. pp. 510, 511.  The Company by way of response asserts that its test year data is reliable and that the switch in accounting systems did not compromise its reliability.  Tr. pp. 1054, 1055.

Staff expressed its opinion that what may appear to be a good corporate decision for United Water Resources, Inc., U.S. or worldwide operations may not necessarily be the most economical decision for the Idaho operation in isolation; that corporate decisions may produce inter-corporate subsidies among the operating units.  Tr. pp. 512, 513.  Staff identified the Company’s vehicle lease program (Tr. p. 513) and ramifications of a municipal condemnation of a UWR subsidiary in Rio Rancho, New Mexico (Tr. p. 514) as activities that raised flags regarding the affiliated web of companies and the related operating consequences affecting UWI.

The Company has agreed to the following Staff proposed adjustments to operating expense:

●Ad valorem adjustment ($18,974)

●Correct info collection rule (SDWA) test schedule($ 2,810)

●Correct purchase water double count($ 1,800)

●Correct employee health insurance $ 9,634

●Correct employee thrift plan($    446)

●Correct telemetry expense($ 7,123)

The Commission Staff has further agreed to reverse a proposed Exhibit 115, Column K ($3,947) payroll tax adjustment, as Staff agrees that it is a duplication of an adjustment already made by the Company.  Tr. pp. 104, 1021-1023.  Also agreed to is a ($168) adjustment to correct the Company’s PUC annual regulatory fee assessment to 1998 actual.  Tr. p. 157.  The related adjustment is $             .  Compare $3,497.  Tr. p. 118.

The Company submitted on May 18, 1998, a (second) amended Exhibit No. 5 Schedule 1, p. 7 setting forth amended power cost calculations based on test year usage and Idaho Power Company 5/16/98 rates.  Reference Order No. 27516.  The related corrected adjustment is $74,484.  Compare ($31,807).  Tr. p. 116.

Eliminate Depreciation Expense Equity Gross-Up ($1,617)

Staff proposed adjustment eliminates depreciation expense related to the rate base adjustment for the equity gross-up calculation the Company began using in its AFUDC calculations.  The depreciation expense adjustment is simply the $                gross capitalized AFUDC divided by the average 50 year life of the Company’s plant in service.  Tr. p. 529; Exhibit 115.

Adjust Transportation Expenses ($115,398)

This proposed adjustment carries through Staff’s correction related to the Company’s switch from its ownership of its vehicle fleet to leasing and reduces the Company’s proposed level of lease expense from $286,800 to $171,402.  Tr. pp. 527, 529 (see rate base discussion).  On rebuttal the Company proposed a ($21,400) reduction to the level of transportation expense requested based on expected lease residual values flowing back to the Company.  Tr. p. 1018.

The Company disputes Staff’s criticism of its lease versus own cost/benefit analysis and believes that the Staff proposed 40.24% reduction in expense allowance for leased vehicles is unreasonable.  Tr. p. 1010.  Staff’s seeming reliance on the fact that the Company’s transportation overhead rate has increased from 6.5% to 11.5% from 1994 to 1997 as an indication that leasing is more expensive than vehicle ownership, the Company states, is erroneous in that the Staff ignores the other side of the equation, the fact that owned vehicles also require a return on rate base and the associated income tax impact.  Tr. p. 1011.  See additional Company analysis, Exhibit 24, Tr. pp. 1012-1018.

Adjust PUC Rate Case Expense ($86,044)

UWI estimates current rate case expense of $300,000.  Staff as detailed in Exhibit 120 adjusts UWI estimated rate case expense for a portion of the rate case expense charges imposed on UWI by the M&S Company and substitutes a five-year amortization period where the Company requested two years.  Tr. pp. 530-532.

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

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

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

Adjust Operating Ratio Adjustment ($3,015)

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

The Company agrees with Staff’s adjustment, except for one point.  Staff has substituted the level of transportation expense on line 3, column b of Exhibit 21, thus lowering the ratio of growth related expenses to revenue.  The calculation of this adjustment, the Company contends, cannot be made until a level of transportation expense is decided.  Tr. pp. 1032, 1033.

Reverse Adjustment for M&S Fees ($80,078)

Staff reverses an adjustment the Company included in its case to budget for increases and fees paid to the M&S Company.  Tr. p. 533.

Services provided to UWI from United Water Management and Services are provided pursuant to an agreement between the companies.  Test period level of Management and Service charges were $868,565.  The Company states, however, that due to recording variations, this level is not representative of the annual expense.  The 1997 charge which contains seven months actual data and five months projected data, indicates a pro forma level of Management and Service charges of $948,643 or $80,078 higher than the test year level.  This higher figure, the Company contends, reflects the level of services received.  Tr. pp. 121, 122.

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

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

Adjust Depreciation Expense IT and Master Plan ($91,907)

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

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

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

Replacing Employee with Contractor $13,013 (Company Rebuttal)

On rebuttal the Company proposes an adjustment to reflect the removal of a proposed new employee (a locator) and attendant labor, benefit and transportation costs as reflected in its direct case ($45,227) and the replacement of this function with contract expense.  Contract expense is estimated to be $58,240 based on the historical level of locator requests, a $13,013 increase over the related proposed employee costs.  Exhibit 21; Tr. pp. 1003, 1004.  The Company maintains that the long-term benefit to the customer is clear.  Tr. p. 1004.

Adjustment for Salary and Benefits Survey Participation

In Order No. 27449, Case No. UWI-W-97-6, the Commission indicated that it expected the Company to make an adjustment to reflect removal from its revenue request, the expense incurred due to its participation in the Western Management Group Salary and Benefit Survey.  The Company reports that no adjustment is indicated, as the billing was paid in July 1997, outside the test year period.  See Exhibit 30.

Scott Woodbury

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