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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

**IN THE MATTER OF EAGLE WATER)
COMPANY'S APPLICATION FOR) CASE NO. EAG-W-09-1
AUTHORITY TO IMPLEMENT A CUSTOMER)
SURCHARGE.) COMMENTS OF THE
) COMMISSION STAFF
)
_____)**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its Attorney of record, Donald L. Howell, II, Deputy Attorney General, and submits the following comments in response to Order No. 30878 issued on August 12, 2009.

BACKGROUND

On January 22, 2009, Eagle Water Company filed an Application to implement an immediate surcharge on customers' water usage in excess of 600 cubic feet per month. The Company also requests permission to access existing funds in its surcharge account. The new surcharge and the balance remaining in the previous surcharge account would be used by Eagle Water to defray the costs of several capital improvement projects and expenses totaling about \$1.5 million. Application at 3-5. The Company states in its Application that the surcharge will be subject to refund if the requested expenses are "not ultimately approved by the Commission for Surcharge recovery." *Id.* at 7 (emphasis added). Eagle Water requests that its Application be processed via Modified Procedure.

On February 23, 2009, the Commission issued Order No. 30734 granting the Company's request for surcharge, subject to refund. The Commission also set a deadline for interested persons to intervene in this case. No Petitions to Intervene were filed. Consequently, the Company and the Staff recommended that the case be processed under Modified Procedure. The Commission agreed, and ordered that the case proceed under Modified Procedure. Order No. 30878. In these comments, Staff is recommending that the Company recover \$953,435: \$351,297 being added to rate base and \$602,138 from the surcharge.

THE APPLICATION

In its Application, Eagle Water sought to recover the costs of constructing several capital projects that are either complete or under construction. In addition, the Company requested recovery of its \$10,000 per month "tie-in" expense with the City of Eagle¹, \$600 in accounting fees, and approximately \$37,500 in legal fees. The costs of the capital improvements and other expenses are outlined below.

<u>Capital Improvements Completed</u>	<u>Cost</u>
Well No. 7	\$605,988
Floating Feather Pressure Reducing Valve	\$ 43,630
Tie-In to City of Eagle	\$ 22,347
Rebuild Well No. 4	<u>\$ 59,755</u>
Sub Total	\$731,720

<u>Capital Improvements in Progress</u>	<u>Cost</u>
Main Booster Station (Motor & Generator)	\$175,100
Well No. 8	<u>\$636,520</u>
Sub Total	\$811,620

<u>Expenses</u>	<u>Cost</u>
Legal & Accounting Fees	
Prior Surcharge Application Legal Fees	\$ 6,048
Engineering Report Legal Fees	\$16,554
Surcharge Extension Applic. Legal Fees	\$14,906
Surcharge Extension Accounting Fees	<u>\$ 600</u>
Legal & Accounting Fees Sub Total	\$38,108
Eagle City Tie-In Expense (\$10,000/month)	<u>\$60,000</u>
Sub Total	\$98,108

¹ In Case No. EAG-W-08-01, the Company agreed to pay the City of Eagle \$10,000 per month so that the utility could serve the Floating Feather Mobile Home Park.

The combined total for the capital improvement projects is \$1,543,340 (\$731,700 + \$811,620) and the total for expenses is \$98,108. See Order No. 30878 at 2.

To defray the costs set out above, the Company proposed to borrow \$995,500 from the Idaho Banking Company. According to the proposed terms of the bank loan, Eagle Water will borrow \$995,500 at 6.75% over a term of seven years. Application, Exh. E. To repay the loan, the Company proposed to implement an immediate surcharge of 48.075% for usage above 600 cubic feet per month.

In addition to the surcharge, the Company also requested permission to access the remaining balance in the surcharge account. At the time of the Application, the Company reported the current balance in the surcharge account is approximately \$218,000. Application at n. 3. The Company proposed to use these surcharge account funds to complete work on the main booster pump and Well No. 8. *Id.* at 6. Completion of Well No. 8 would allow the Company to terminate its tie-in agreement with the City of Eagle, thereby saving \$10,000 per month.

Even with the surcharge, Eagle Water asserted that its overall rates “would remain well below those of the City of Eagle and United Water of Idaho.” Application, Exh. H. Eagle Water maintained that an immediate surcharge (subject to refund) is necessary to ease its cash flow restrictions “brought about by the need to complete Well No. 7 and the City of Eagle tie-in in order to satisfy DEQ regulatory requirements and lift the sanitary restrictions moratorium.” Application at 7. The current constriction of the Company’s cash flow severely limits Eagle Water’s “ability to meet current demands for payment of other capital improvements that are underway.” *Id.* The Company requested that the surcharge take immediate effect. *Id.*

THE COMMISSION’S PRIOR ORDER

In Order No. 30734 issued February 23, 2009, the Commission allowed Eagle Water to implement its surcharge subject to refund. The Commission observed that because the surcharge is subject to refund, “ratepayers are protected until the Commission has completed its review of the reasonableness and prudence of the Company’s capital costs and expenses set out in its Application.” Order No. 30734 at 4. The Commission also noted that the impact of implementing the surcharge now would be mitigated because the irrigation season has not started. *Id.*

The Commission also found it was reasonable to allow the Company to execute the bank loan and access the remaining balance in the previous surcharge account. The Commission

observed that completing Well No. 8 would allow Eagle Water to terminate its tie-in agreement with the City of Eagle, thereby terminating a \$10,000 per month expense. *Id.*

STAFF COMMENTS AND ANALYSIS

A. Brief System Description and Operational Issues

According to Eagle Water's 2008 Annual Report, the Company currently serves 2,955 residential and 445 commercial accounts for a total of 3,400 customers. Its water supply is currently provided from six wells (Well Nos. 1, 2, 3, 4, 6 and 7). A seventh well (Well No. 8) has been recently drilled but is not yet completed or operational. In the past, there have been operational issues in the water distribution system, such as low operating pressures in some areas (i.e., Eagle Springs subdivision) and the system's non-compliance with existing Idaho Rules for Public Drinking Water Systems (IRPDWS) promulgated by the Idaho Department of Environmental Quality (DEQ) (i.e., mechanical redundancy requirements, maintaining minimum water pressure at peak hour flow, etc.). Consequently, DEQ placed a development moratorium on the Company's certificated service area until remedial actions were taken to bring the system into compliance with the rules.

On August 1, 2005, DEQ issued a "Notice of Violation" (NOV) to Eagle Water citing the Company's failure to maintain minimum water pressure in portions of the Company's water distribution system. On August 3, 2005, the Commission issued an emergency Order directing Eagle Water to immediately address the deficient water pressure in the affected areas. Order No. 29840, Case No. EAG-W-05-01. The Order also directed the Company to prepare an engineering report for its entire system to address near- and long-term pressure problems. On February 17, 2006, DEQ entered a Consent Order with Eagle Water to perform several actions related the NOV.

B. Engineering Report

As contained in Order No. 29840, page 3, the Commission directed Eagle Water to assemble an engineering report that:

...shall include a comprehensive analysis of the existing system including projected water needs out to 2010. The analysis will consider all possible options including additional water supply, storage, booster pumps and additional mainlines necessary to meet the existing and projected water requirements. The report shall include the recommended system improvements, construction

schedule and estimated costs of each individual project. Eagle Water and its engineer shall work closely with the Commission Staff in preparation of this report.

The engineering study evaluated and modeled different options for improving system operations, and developed a list of recommendations. The recommendations were divided into various categories such as "Completed Actions", "Mandatory Actions", "Future Actions" and "Suggested Actions". Completed Actions are recent improvements that have enhanced current water system operations. Mandatory Actions are those immediately required to bring the system into compliance with DEQ regulations. Future Actions are recommendations required to support future development. Suggested Actions are items that would optimize the water system but were not required.

C. Completed Actions

Eagle Water indicated in its Application that several of the system improvements as recommended by the June 2007 Final Engineering Report have been completed and some are in the process of being completed. These projects have a total cost of about \$1.54 million. The completed projects include construction and interconnection of Well No. 7 and repair of Well No. 4. Eagle Water states that because these capital expenditures are in the public interest, the Company is requesting an Order from the Commission finding that the investments are prudent and recoverable from customers through a surcharge.

1. Well No. 7

Eagle Water completed the development of Well No. 7 as an additional water supply to meet growing summer demand and provide a backup water source in compliance with DEQ Rules for Public Drinking Water Systems, APA 58.01.08. Transmission piping was also installed to connect Well No. 7 to the existing Eagle Water distribution system. Because Well No. 7 is a new water source, the IRPDWS requires that it be provided with a standby power supply. Therefore, the Well is equipped with a dedicated, standby 365-kw diesel-powered generation unit to comply with current DEQ regulations. Well No. 7 is equipped with a 200-hp vertical turbine pump and a variable frequency drive (VFD) which can operate from zero flow to a maximum of 1,900 gpm.

The well was completed on March 5, 2006 and DEQ conditionally approved Well No. 7 to serve Eagle Water customers on August 8, 2006.

Staff inspected this project during the Eagle Water system inspection on May 22, 2009 and found it pumping approximately 700 gpm at a discharge pressure of 105 psi. Staff believes it was appropriate for the Company to undertake the construction of Well No. 7 with the standby power unit to provide additional summer peaking capacity and comply with drinking water regulations. This specific project is considered by Staff to be "used and useful."

The Company initially requested in its Application to recover a total cost of \$605,988 for the construction of Well No. 7. In response to Staff Production Request No. 1, the Company provided Staff with the costs broken down into various categories. After Staff's review of invoices and discussions with the Company concerning the costs presented, the Company again revised its estimates with the following cost breakdown:

Land purchase	\$ 48,782.50
Well drilling/development	\$115,624.00
Pump and motor	\$ 34,659.00
Electrical controls	\$ 27,958.96
Variable frequency drive	\$ 13,230.00
Appurtenances	\$ 25,030.00
Pump facility building	\$ 89,894.24
Back-up generator	\$ 89,914.60
Mainline tie-in	\$114,023.97
Engineering cost	<u>\$ 17,535.54</u>
TOTAL	\$576,952.81

Staff reviewed the cost of various work elements required to construct Well No. 7, to determine if they were reasonable. In Production Requests No. 6, 10, 14, 19, 28 and 34, Staff asked the Company to explain cost control efforts applied by the Company in contracting and/or paying for project work elements. Eagle Water indicated that its 35 years of experience made the Company more capable of managing and completing construction of necessary water system infrastructure more reliably and cost effectively than third-party contractors. The Company explained that instead of hiring a general contractor to perform the tasks needed to complete all of the projects, including Well No. 7, the Company managed and coordinated the work and used Eagle Water Construction Company to provide the equipment and labor. Robert DeShazo, President of Eagle Water, is also the owner of the construction company. The total cost paid by Eagle Water to the Construction

Company includes the labor, use of the Construction Company's equipment, cost of materials, and profit and overhead of 15% of the total cost of labor, equipment and materials. It is not unusual for owners of small public water systems to use affiliated construction companies to provide labor and other services to the water companies that they own. Staff believes this is appropriate as long as the cost is competitive to unaffiliated alternatives. The Commission has allowed this practice in previous cases.

The Company did hire contractors to perform specialized tasks such as drilling and developing the well, installing the VFD, pump and motor, and other electrical controls. Drilling and development of Well No. 7 was put out for bids, however only one bid was received due to high demand for well drillers during the construction boom. Eagle Water Company continued to rely on vendor(s) that had provided the same products and services to the Company in the past to supply engineering, pumps, motors, VFD and electrical controls.

Staff believes that the costs incurred by the Company to complete most of the project elements for Well No. 7 were reasonable compared to other jobs of similar size and scope. Staff also believes that the Company spent considerably less money than it would have spent if it had hired third-party contractors to complete project construction.

However, Staff believes the 365-kW standby power generation unit is oversized to operate the 200-hp pumping unit for Well No. 7. Staff researched industry practices concerning sizing of a standby power generation unit and obtained recommendations for a 200-hp water pumping unit equipped with variable speed drive for a public water system. Staff was informed by industry representatives that several factors are involved in sizing the unit but as a general rule, the recommended size for backup power supply for this application would range from 180-kW to 230-kW. Using the upper range of the recommended size (230-kW), Staff believes the Company oversized stand-by power generation (365-kW) by 135-kWs. The Company failed to provide justification for over-sizing the unit, although Staff was informed that when the Company was looking for a back-up generator, it coincided with the Hurricane Katrina disaster and it was very difficult to get generators available in the market. The Company decided to purchase a used generator. Staff does not disagree with the Company's decision to purchase a used generator but disagrees with the size of the generator it purchased. Staff does not believe that the Company's customers should have to pay the extra cost of an oversized generation set. Therefore, Staff proposes an adjustment of \$10,356 ($\$28,000/365 \text{ kW} \times 135 \text{ kW}$) to the total cost of Well No. 7.

