Office of the Secretary
Service Date
December 13, 2006

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF CAPITOL WATER CORPORATION FOR AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR WATER SERVICE IN THE STATE OF IDAHO	**CASE NO. CAP-W-06-01** **ORDER NO. 30198**

On June 21, 2006, Capitol Water Corporation ("Capitol Water" or "Company") filed a general rate case application seeking authority to increase its rates approximately 27.8%. If approved the Company's revenues would increase by $132,449 annually. Capitol Water provides service to approximately 2,875 customers in Boise, Idaho. The Company's Application included proposed tariffs and requested an effective date of August 1, 2006.

On July 7, 2006, the Commission issued an Order and Notice of Application. In this Order, the Commission suspended the proposed effective date of the Company's proposed rates and directed the Commission Staff to conduct an audit of the Application and present its audit findings in Staff comments. Order No. 30098. The Commission would then decide how it wished to process the Application.

On September 6, 2006, the Commission issued a Notice of Modified Procedure and Public Workshop. Order No. 30124. The Commission solicited comments from the public and established a comment deadline of October 12, 2006 and a reply comment deadline of October 26, 2006. *Id.* The Staff and two members of the public timely filed comments. The Company timely filed reply comments. On November 20, 2006, Staff filed supplemental comments (Supplemental Comments). A public workshop was held on September 25, 2006 at the Commission's Hearing Room.

THE APPLICATION

Capitol Water's Application stated that since the entry of the final Order in its last (1995) rate case, it has been necessary to implement certain capital improvements. Application at 1 referencing Order No. 26247. The Commission has authorized two surcharges to recover the Company's capital improvement costs, in June 1997 and July 2003.

To meet continued capital investment needs, the Company requested a revenue requirement increase of $132,449 resulting in a percentage increase of approximately 27.8%. The Company proposed to change the months subject to the summer rate schedule to include the month of April, which would provide approximately $27,000 in additional revenue. The Company further proposed spreading the remainder of the requested additional revenue requirement across its customer classes, resulting in a 22.21% increase in base rates for all customers.

DISCUSSION

The Commission has reviewed and considered the filings of record in Case No. CAP-W-06-1, including Staff's comments and recommendations, the Company's reply comments and the comments of customers.

Public Comments

Two comments were received from the Company's customers. One commenter voiced support of the Company's Application. The other commenter noted that it had been reported that the Ada County Highway District (ACHD) had announced a plan to widen certain areas of Ustick Road, which would require the Company to move and replace some of its water lines. The commenter requested that the Company's costs for this replacement be subtracted from the rate increase request and that these costs be borne by ACHD and not Capitol Water customers.

We would like to reassure the Company's customers that no expenses for the proposed ACHD improvements are included in the Company's Application or in the rates approved by this Order. If the Company does incur such expenses in the future and seeks reimbursement of them through rates or surcharges, it will need to file a request for such recovery with the Commission, with appropriate notice to all customers.

Staff and Company Comments

Staff examined the books and records of the Company for the fiscal year ending December 31, 2005. The audit included examination of general ledger accounts and supporting vouchers and invoices, verification of physical plant and property, and discussions with the Company owners and employees. The Company does not employ an independent auditor to audit its financial statements; however, it does employ an accounting firm to facilitate the preparation of the annual reports required by the Commission and to prepare its federal and state tax returns.

TEST YEAR, REVENUES & EXPENSES

The Company proposed using the actual test year data for 2005. The Application was based upon the actual recorded performance of the Company for 2005 and is comparable to the 2005 annual report filed with the Commission. The actual 2005 data was not adjusted for any known and measurable changes beyond the test year because the Company believes that the 2005 test year is indicative of the Company's continuing operations. Staff agreed to use of a 2005 test year as adjusted below.

Staff noted that the Company's accounting for operating revenues is consistent with the requirements of the Uniform System of Accounts, as adopted by this Commission. In 2005, the Company's actual operating revenues totaled $475,805, and the major sources of revenue were the sale of water to unmetered residential customers (Schedule 1 – $375,977), metered sales to commercial and industrial customers (Schedule 2 – $94,151), and fire protection revenue (Schedule 3 – $4,788). The Company did not propose any adjustments to revenue in the Application. Staff proposed that annual test year revenues be adjusted by $6,493 to reflect what current rates should generate when applied to the number of existing year-end customers and the commodity consumed.

Staff believes that the operating expenses for Capitol Water are, for the most part, properly recorded on the books of the Company. Operating expenses have increased since the last general rate case in 1995. Staff proposed adjustments to the Application that fall into the following categories:

- Reclassification of expenses between accounts,
- Removal of below-the-line expenses, or expenses that would be inappropriate to recover through rates,
- Annualization of water testing expenses, and
- Inclusion of expenses currently being paid by surcharge funds.

Staff proposed 13 adjustments to operating expenses. The first six (Staff Adjustments A through F) reclassified expenses from one account to another account and did not affect the Company's revenue requirement. The next four (Staff Adjustments G through J) removed expenses for ratemaking purposes, as these expenses are below-the-line expenses. The following two adjustments annualized water-testing expenses, and the last adjustment included expenses that have previously been charged to Capitol Water's surcharge fund account.

Removal of Below-the-Line Expenses

1. Vehicle Expenses. Staff Adjustments G, H and I removed expenses related to personal use of Company-owned vehicles. Through discussions with the Company's owners and officers, Staff determined that at least 50 percent of the vehicle use is personal use and not business related.

Staff Adjustment G ($85) removed half of the cost of licensing the Company-owned vehicles driven by Company owners. Staff Adjustment H ($3,145) removed half of the transportation expense for the Company-owned vehicles driven by the owners. Staff Adjustment I ($4,085) removed the depreciation expense attributable to one of the two Company-owned vehicles. The vehicles are depreciated over a five-year life, using the half-year convention. Each vehicle was fully depreciated by the end of the test year. Therefore, it is reasonable to remove all of the depreciation expense associated with them and no adjustment to rate base is necessary.

In its audit, Staff noted that repairs and maintenance expenses are documented for each vehicle. However, other expenses, especially car washes and gasoline purchases, are not identified by vehicle. The monthly statement for the credit card used for the purchase lacks clarification as to which vehicle has been washed or which gasoline tank filled.

Staff stated that the Company has neither maintained records associated with personal use of the Company vehicles nor kept transportation expense records for each vehicle. However, Staff believes it is unreasonable to disallow all transportation expenses, as some level of expense is justified. In the absence of future improved recordkeeping, Staff recommended that all gasoline and other miscellaneous purchases, such as car washes, for vehicles driven by the owners be paid for with personal funds, and that they be reimbursed by the Company for business miles using the standard mileage rate set by the Internal Revenue Service (IRS) as a proxy for the actual cost. This requires that a logbook of business miles must be kept. The total of Staff vehicle-related adjustments is $7,315.

With regards to the vehicle expenses, the Company explained that it attempted to comply with prior Commission Orders to account for the separate expenses for each vehicle. It had obtained separate credit cards for each from a major oil company; however, the Company began patronizing a discount gasoline provider when prices markedly rose and was unable to use the separate cards. In addition, the Company believes that Staff's proposal for the Company to "maintain accurate log books" is "administratively burdensome and unworkable." The Company stated that it is willing to agree with Staff's proposal of a 50/50 split of business and personal use with regards to vehicle expenses, but it objects to the requirement to accurately track the actual use of each vehicle.

Finding: We approve the adjustments made by the Staff in removing half of the licensing, transportation and depreciation expenses. We find that an equal division of the vehicle expenses for business and personal use may be reasonable, and approve of this division for the current revenue requirement. However, we have not seen clear evidence that at least 50% of the use of the owners' vehicles is business-related. Therefore, we direct the Company owners to maintain a logbook of the miles driven for business purposes. In the Company's next rate case, it will need to provide clear evidence of the owners' use of these vehicles for business purposes. Otherwise, we shall not be inclined to allow any request for vehicle-related expenses of Company owners.

2. Holiday Event. Staff Adjustment J ($392) removed expenses for Company year-end holiday events for employees. The Company concurred that this adjustment was reasonable.

Finding: We find that this adjustment is reasonable and approve removal of these expenses from the Company's revenue requirement. The Commission has traditionally moved these types of expenses below-the-line for ratemaking purposes, as they do not directly benefit customers.

Annualization of Water Testing Expenses

Staff proposed adjustments to annualize the water testing expenses. Staff Adjustment K ($2,503) removed the actual amount of the water testing expenses included in the test year and Staff Adjustment L ($5,313) replaced the actual expenses for water testing with an annualized amount. The average cost per well for all required tests is $885.58 and the Company has six wells that require water testing. The average cost per well was calculated by the Company and is acceptable to Staff. The net Staff adjustment for water testing is $2,810.

Finding: We find that it is reasonable to include the annualized rates for water testing expenses in the Company's revenue requirement. As not all water tests are performed every year, and several of the tests that are performed less frequently are quite costly, it is more equitable to use the average yearly cost of water testing expenses when setting rates.

Inclusion of Expenses Currently Being Paid by Surcharge Funds

There are several expenses that are currently being paid by surcharge funds. One of these is the Company's electric expense for the annual Power Cost Adjustment (PCA). Order No. 28801 authorized the Company to charge incremental electric expenses resulting from Idaho Power Company's electric PCA surcharge(s) against Capitol Water's surcharge account. This was accomplished by applying the Idaho Power PCA surcharge rate, which at that time was $0.013415 per kilowatt hour (kWh), to the billed kWh on each bill to determine the amount of the electric surcharge authorized to be charged against the balance of Capitol Water's surcharge account.

The current expenses for power included in the Company's Application did not include the past portion of the PCA rate that was charged to the Company's surcharge account, and are reflective of current power expenses going forward. Although the current PCA rate results in a credit (as opposed to a surcharge), Staff did not propose a reduction in the amount of power expense included in the test year. Staff believes the Company's surcharge funds should no longer be used for power expenses, as the 2005 test year expenses should be more than sufficient to cover the ongoing power costs of Capitol Water.

Second, the Company was authorized to recover the cost of sequestering chemicals through the surcharge funds. The amount spent for phosphates from the surcharge account during 2005 is $14,796. Staff Adjustment M included this amount in the calculation of base rates. Since the surcharge was first implemented in June 1997, the expenses related to the sequestering chemicals have been charged to the surcharge account.

In its reply comments, the Company identified two additional expense adjustments that are or should be paid from the surcharge revenue. First, are the charges that reflect the ongoing cost to inspect, service and maintain the standby generator. This adjustment increases the revenue requirement by $1,718 for an incremental increase of 0.36%. Staff agreed with the Company's argument that this expense is similar to the PCA expense and the sequestering chemical expenses noted above.

Another expense noted by the Company in its reply comments was a proposal to amortize and include rate case expenses in the final revenue requirement. Staff noted that, if accepted, the total rate case expenses of $3,588 would be amortized over three years for an expense increase of $1,195 and an incremental revenue requirement increase for rate case amortization of $1,554 or 0.33%.

Finding: We find that it is reasonable that the above-noted expenses be recovered through rates rather than through the surcharge. These are all recurring expenses necessary for the operations of the business, or are otherwise appropriate for recovery through rates. This shift in the source of funds for payment for power and chemical expenses will allow the Company to retire the surcharge sooner. We direct the Company to use the amounts raised through the surcharge to retire the Company's loan as soon as possible.

CAPITAL STRUCTURE

Staff agreed with the Company's proposed capital structure and overall rate of return, including a return on equity of 12%. Staff accepted the Company's method of calculating working capital, one-eighth of annual Operating and Maintenance expenses. Due to Staff's adjustments to operating expenses, however, Staff suggested an adjustment of $1,844 to the resulting working capital.

Staff's gross-up factor calculation uses the Company's actual bad debt expense to arrive at Staff's net to gross multiplier. In discussions with the Company, Staff noted that bad debts are not particularly large, and that the amount included in the test year is typical. Therefore, Staff used the actual amount of bad debt expense in its calculation of the net to gross multiplier.

Finding: We find that the proposed return on equity is reasonable, and approve Staff's adjustment to the Company's working capital.

METERING

None of Capitol Water's residential customers are currently metered, and such metering was last considered in Case No. CAP-W-96-2. Staff, as part of evaluating this case, again considered the possibility of metering Capitol Water's residential customers. The key issues considered were: (1) consumption patterns including conservation and the effects of drought on the aquifer; and (2) the effect of the cost to meter on Capitol Water's customers.

Staff compared the consumption patterns, using 2005 data, of Capitol Water's residential customers with those of Falls Water, Bitterroot Water and United Water customers. The Capitol Water residential water consumption is significantly higher on an annual basis than all of the others. However, it is nearly identical to the most similar companies, Falls Water and Bitterroot Water, in peak consumption rates.

Staff also contacted the Idaho Department of Water Resources (DWR) for information regarding Capitol Water's impact on the aquifer. DWR concluded that the minor drawdown of that aquifer over the past few years is solely caused by the drought the surrounding area has experienced. It further noted that the aquifer dropped similarly in past droughts and recharged after the droughts.

The expected costs to meter the residential customers in Capitol Water's system would be higher than in 1996 but would probably not exceed $1,500,000. This could result in a 35% or greater impact on customers' rates.

Finding: We find that it would not be reasonable to impose metering upon the Company's customers. The costs involved are substantial and potentially a burden on the Company's customers. Currently, the water consumption by Capitol Water customers has not been deemed as adversely impacting the aquifer, and current capacity is adequate to meet demand. If, in the future, we find evidence that the demand is negatively affecting the aquifer, or that metering is otherwise more cost-effective, we may direct the Company to meter part or all of its residential customer base.

RATE DESIGN

Summer Rates

The Company proposed to include the month of April in Schedule 1 summer rates. Currently, summer rates are in effect from May through September. Staff did not recommend changing the summer rates for Capitol Water to include April. The Company had no objection to the Staff's analysis.

Finding: We find no reason to modify the current summer rate schedule to include the month of April. The summer rate schedule will continue to include only the months of May through September. Including April in summer rates would not be consistent with other water companies in the area. Staff reviewed the rate schedules of United Water and Eagle Water and neither company includes April in their summer rates. Although absolute uniformity is not required, having similar structures among water utilities is preferred. In addition, Staff's review and evaluation of the Company's power consumption and energy use did not demonstrate that April's use was comparable to that from May to September. In fact, the Company's water use in

April is substantially less than in the current summer months. Finally, the evapotranspiration analysis that was performed by Staff demonstrated that April water demand for a lawn is noticeably lower than the demand from May through September. Based on these analyses, we are not convinced that water use in the month of April is sufficiently high to justify including April in the summer rate schedule.

Schedule 3- Fire Hydrants

Staff's proposed rate design includes one major change, to eliminate Schedule 3, public fire hydrants, and allocate the costs to Capitol Water base rates. Currently, Schedule 3 consists of a flat rate per hydrant of $2.34, which is currently paid by the City of Boise. There are two significant reasons for Staff's proposed change: (1) this proposal is consistent with other Idaho water companies that all collect hydrant costs from their customers; and (2) Staff believes charging the City of Boise for fire hydrants poses an inequity to Boise citizens. The Company agreed with Staff's analysis.

Finding: We find that it is reasonable to remove Schedule 3 from the Company's tariff and that it is appropriate to integrate the fire hydrant charges into Capitol Water rates. Charging the City of Boise results in a subsidy to Capitol Water customers paid for by other Boise City water customers that pay both city taxes and hydrant costs in water rates. As this is only a change in the source of revenues and not new revenues, there is no gross-up for taxes as the Company stated in its reply comments.

Allocation of Revenue Requirement

Staff generally supported the recommendation of the Company to spread the revenue requirement increase uniformly across all rate components. Taking into account all proposed adjustments (including those described below), the revenue requirement for Capitol Water is $624,713, which is an overall revenue increase of 31.3%.

Subsequent to filing its initial comments, Staff discovered an error identifying the minimum allocation of water included in rates for its metered customers. This resulted in the Staff adjustment to customer revenues being incorrectly calculated. This adjustment should be removed, increasing the revenue deficiency by $6,493.

To meet the revenue requirement of $624,713, Staff applied a weighted average increase of rates to establish the correct allocation of revenue from overall revenue and rounded the tariff charges. The tariff proposed by Staff results in an overall increase to tariff rates of 38.75% due to the rounding of rates over the Company's prior tariff rates.

Schedule 1 consists of non-metered customers, generally residential, designed as a flat rate that varies according to service line size. This schedule also includes an additional monthly flat summer surcharge for all customers, which also varies according to service size. To meet the targeted revenue, Staff proposed that the flat charge and the summer surcharge be increased by 38.99% for Schedule 1, as shown in Attachment A hereto. For example, the Staff proposed change would result in a $12.10 flat charge for a ¾" line and a $15.40 summer surcharge. *See* Attachment A.

Schedule 2 consists of metered customers, generally commercial and industrial. These customers are charged a minimum monthly charge based on the service size plus a declining block commodity charge. Staff proposed that the relationship between the base rate and the commodity rate remain unchanged and that all rates on Schedule 2 be increased by approximately 38.99%. *See* Attachment A. The only proposed change to Schedule 4, fire protection services (such as sprinkler systems), is an average increase of 38.99% to all of the rates. *Id.*

Finding: *Idaho Code* §§ 61-301 and 61-307 require the Commission to establish just and reasonable rates for each public utility. We find the proposed annual revenue requirement for Capitol Water of $624,713 to be just and reasonable. We find the rate design proposed by the Staff in Attachment A hereto to be a just and reasonable allocation of the Company's revenue requirement among its customers. The proposed rate design maintains the relationship previously established among the various users and reflects their demand on the system. In addition, we find that it is necessary for the Company to specifically state the minimum allocations of water for each class of customer in Schedule 1 in its tariff sheets that it files pursuant to this Order.

CONCLUSIONS OF LAW

The Commission has jurisdiction and authority over Capitol Water Corporation, a water utility, and the issues raised in Case No. CAP-W-06-1, pursuant to Title 61 of the Idaho Code and the Commission's Rules of Procedure, IDAPA 31.01.01.000 *et seq*.

ORDER

IT IS HEREBY ORDERED that the Commission approves a $148,908 or 31.3% increase in authorized annual revenues for Capitol Water Company, for a total authorized annual revenue requirement of $624,713. Our revenue requirement calculation includes an authorized 12% rate of return on equity.

IT IS FURTHER ORDERED and the Commission does hereby establish rates and charges for water service as set out above. The Company is required to file tariff sheets consistent with this Order. The rates and charges we approve will be effective January 1, 2007.

THIS IS A FINAL ORDER. Any person interested in this Order may petition for reconsideration within twenty-one (21) days of the service date of this Order. Within seven (7) days after any person has petitioned for reconsideration, any other person may cross-petition for reconsideration. See *Idaho Code* § 61-626.

DONE by Order of the Idaho Public Utilities Commission at Boise, Idaho this 12th day of December 2006.

PAUL KJELLANDER, PRESIDENT

MARSHA H. SMITH, COMMISSIONER

DENNIS S. HANSEN, COMMISSIONER

ATTEST:

Jean D. Jewell
Commission Secretary

O:CAP-W-06-01_cg3

Table 1: Current and Proposed Base Rate Design

Schedule 1	Service Size	Current Tariff	Company Proposed Tariff	Commission Approved Rates
		Monthly Flat Charge	Monthly Flat Charge	Monthly Flat Charge
Flat Rate	3/4"	$ 8.65	$ 10.57	$ 12.10
	1"	$10.45	$12.77	$ 14.50
	1 1/4"	$ 11.66	$ 14.25	$ 16.20
	Additional Summer Charge May-Sep	$11.07	$13.53	$ 15.40

Schedule 2	Service Size	Current Tariff		Company Proposed Tariff		Commission Approved Rates	
		Monthly Minimum Charge	Commodity Charge	Monthly Minimum Charge	Commodity Charge	Monthly Minimum Charge	Commodity Charge
Metered Customers	3/4" and Smaller	$ 5.54	First 1,000 ft^3: $0.85 per 100 ft^3	$ 6.77	First 1,000 ft^3: $1.04 per 100 ft^3	$ 7.70 (Includes 700 ft^3)	First 1,000 ft^3 over minimum charge: $1.18 per 100 ft^3
	1"	$ 7.78		$ 9.51		$ 10.80 (Includes 1,000 ft^3)	
	1 1/2"	$11.37	Second 1,000 ft^3: $0.48 per 100 ft^3	$ 13.90	Second 1,000 ft^3: $0.59 per 100 ft^3	$ 15.80 (Includes 1,600 ft^3)	Second 1,000 ft^3 over minimum charge: $0.67 per 100 ft^3
	2"	$19.62	Remaining ft^3: $0.36 per 100 ft^3	$ 23.98	Remaining ft^3: $0.44 per 100 ft^3	$ 27.30 (Includes 3,800 ft^3)	Remaining ft^3 over minimum charge: $0.50 per 100 ft^3
	3"	$35.20		$ 43.02		$ 48.90 (Includes 8,100 ft^3)	

Attachment A
Case No. CAP-W-06-01
Order No. 30198

Schedule 3		Current Tariff	Company Proposed Tariff	Commission Approved Rates
	Service Size	Monthly Flat Charge	Monthly Flat Charge	Monthly Flat Charge
Hydrants	Fire Hydrant	$ 2.34 per Hydrant	$ 2.86 per Hydrant	N/A

Schedule 4		Current Tariff	Company Proposed Tariff	Commission Approved Rates
	Service Size	Monthly Flat Charge	Monthly Flat Charge	Monthly Flat Charge
Fire Protection	3"	$ 6.08	$ 7.43	$ 8.50
	4"	$ 8.50	$ 10.39	$ 11.80
	6"	$ 19.43	$ 23.75	$ 27.00
	8"	$ 31.56	$ 38.57	$ 43.80
	10"	$ 48.50	$ 59.27	$ 67.30