DECISION MEMORANDUM

TO: COMMISSIONER KJELLANDER
COMMISSIONER SMITH
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COMMISSION SECRETARY
COMMISSION STAFF
LEGAL

FROM: CECELIA A. GASSNER
DON HOWELL

DATE: NOVEMBER 22, 2006

SUBJECT: CAPITOL WATER CORPORATION'S GENERAL RATE CASE APPLICATION, CASE NO. CAP-W-06-1

On June 21, 2006, Capitol Water Corporation 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. The Company's Application includes proposed tariffs and requests 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 pursuant in Staff comments. Order No. 30098. The Commission would then decide how it wishes to process this 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. *Id.* *See* Order Nos. 27022 and 29306.

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%. Application at 2-3. 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. *Id.* at 3. 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. *Id.*

THE COMMENTS

A. 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.

B. Staff 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. Staff Comments at 2.

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. *Id.* 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 (Adjustment N). *Id.*

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. *Id.* at 3. Staff proposes 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) involve reclassifying expenses from one account to another account and do not affect the Company's revenue requirement. The next four Staff adjustments 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. *Id.*

1. Removal of Below-the-Line Expenses. Staff Adjustments G, H, and I remove expenses related to personal use of Company-owned vehicles. Through discussions with the Company owners and officers, Staff determined that at least 50 percent of the vehicle use is personal use and not business related. *Id.* at 4.

Staff Adjustment G ($85) removes half of the cost of licensing the Company-owned vehicles driven by Company owners. Staff Adjustment H ($3,145) removes half of the transportation expense for the Company-owned vehicles driven by the owners. *Id.*

Staff Adjustment I ($4,085) removes the depreciation expense attributable to one of the two Company-owned vehicles. The vehicles are depreciated over a 5-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. *Id.*

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. *Id.* at 5.

Staff stated that the Company has not maintained records associated with personal use of the Company vehicles, nor has the Company kept transportation expense records for each vehicle. However, Staff believes it is unreasonable to disallow all transportation expenses, as some level of expense justified. In the absence of future improved record keeping, 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. This requires that a logbook of business miles must be kept. The owners could be reimbursed by the Company using the standard mileage rate set by the Internal Revenue Service (IRS) as a proxy for the actual cost because it is an established and neutral rate that could be used to reimburse business expenses to the owners. The total of Staff adjustments G, H, and I is $7,315. *Id.*

Staff Adjustment J of $392 removes expenses for Company year-end holiday events for employees. The Commission has traditionally moved these types of expenses below-the-line for ratemaking purposes, as they do not directly benefit customers. *Id.*

2. <u>Annualization of Water Testing Expenses</u>. Staff Adjustments K and L annualize the water testing expenses. Adjustment K removes the actual amount of the water testing expenses of $2,503 included in the test year and Adjustment L replaces the actual expenses for water testing with an annualized amount of $5,313. Because not all water tests are performed every year, and several of the tests that performed less frequently are quite costly, it is more equitable to use the average yearly cost of water testing expenses when setting rates. 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. *Id.* at 5-6.

3. <u>Inclusion of Expenses Currently Being Paid by Surcharge Funds</u>. There are several expenses that are currently being paid by surcharge funds. First, 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. *Id.* at 6.

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 is not proposing 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. In fact, because the current Idaho Power PCA resulting in a reduction to rates, the amount included in power expenses for ratemaking purposes will most likely prove to be greater than the actual power costs going forward (at least through May 2007). *Id.*

Staff made no adjustment to the amount included in the Application. Staff recommended that the surcharge account no longer be used to pay for the excess power costs, now that the power costs are being updated in this rate case. Staff noted that the Company may file another rate case if it determines that increased power costs or other expenses necessitate filing for rate relief. *Id.*

Second, the Company was authorized to recover the cost of sequestering chemicals. 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 of 1997, the expenses related to the sequestering chemicals have been charged to the surcharge account. Staff notes that these expenses will continue beyond the life of the surcharge and are more appropriately reflected in base rates going forward. *Id.* at 7.

In summary, Staff recommended that the Company be directed to continue with the surcharge as it is currently in place, and that the Company no longer use surcharge funds for power expenses or sequestering chemical expenses, as Staff recommended including these expenses in base rates. This shift in the source of funds for payment for power and chemical expenses will allow the Company to retire the surcharge sooner. *Id.*

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 expense and any associated taxes from the increased revenue will be accounted for as part of the normal business operation rather than the surcharge. 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. Supplemental Staff Comments at 2.

Another expense noted by 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%. *Id.*

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. Comments at 8.

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 notes 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. *Id.*

Rate Issues

1. System Condition. As part of its evaluation of the Company's Application, Staff accompanied the owner and operator on an inspection tour of the system. All aboveground facilities were visited and inspected. A high level of cleanliness and maintenance of equipment was observed. The owner has installed newer instrumentation and keeps all equipment in good working order. The Company's shop, where repairs and modifications are made, was found to be well organized and stocked with spare parts. Comments at 8.

2. 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. *Id.* at 8-9.

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. *Id.* at 9-10.

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 drought. *Id.* at 10.

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. In view of the substantial costs, the fact that water consumption by Capitol Water customers has not been deemed as adversely impacting the aquifer, and current capacity is adequate to meet demand, metering is not recommended at this time. If, at a later date, it is determined that the aquifer is being adversely affected, or it is determined that additional supply is needed, Staff may reconsider its metering recommendation. *Id.*

Rate Design

Staff generally supports the recommendation of the Company to spread the revenue requirement increase uniformly across all rate components. However, Staff has two modifications as described in greater detail below. Taking into account all proposed adjustments (including those described below), if accepted by the Commission, the revenue requirement for Capitol Water would be $624,713, which is an overall revenue increase of 31.3%. Supplemental Staff Comments at 3.

Subsequent to filing its initial comments, the 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. *Id.*

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. *Id.*

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 proposes that the flat charge and the summer surcharge be increased by 38.99% for Schedule 1. For example, the Staff proposed change would result in a

$12.10 flat charge for a ¾" line and a $15.40 summer surcharge. This increase maintains the current relationship between the respective charges as set forth in Attachment A to Supplemental Comments.

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 does not recommend changing the summer rates for Capitol Water to include April for three specific reasons. *Id.* at 11.

First, 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. Second, 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. Finally, Staff conducted an evapotranspiration analysis to examine Boise lawn water demand. Staff believes that the 2005 data is representative of typical growing conditions for Boise area lawns. This analysis shows that April water demand for a lawn noticeably lower than the demand from May through September. Based on these analyses, Staff was not convinced that water use in the month of April is sufficiently high to justify including April in the summer rates. *Id.*

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, who 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. Charging the City of Boise results in a subsidy to Capitol Water customers paid for by other Boise City water customers (United Water Idaho) that pay both city taxes and hydrant costs in water rates. Therefore, Staff believes that it is appropriate to integrate the fire hydrant charges into Capitol Water rates. The only proposed change to Schedule 4, fire protection services (such as sprinkler systems), will be the approved average increase. *Id.* at 12.

Staff stated in its Supplemental Comments that the revenues from the hydrants during the test period will now be received from other customer groups. This is only a change in the source of revenues and not new revenues, so there is no gross-up for taxes as the Company stated in its Reply Comments. Supplemental Staff Comments at 2-3.

Customer Relations

Staff believes that the Company fulfilled the Notice requirements to its customers, including sending a notice in a billing statement and conducting a Public Workshop. Staff also noted that the Commission has received only one complaint regarding the Company since 2001. Comments at 12-13.

Computer Billing Error

A computer billing error was discovered by Staff when re-evaluating the customer revenue adjustments. This error was caused by incorrect programming and resulted in an over-collection of $21,553 from metered customers. The Company has corrected this error and will file a proposal to properly return the over-collection to the affected customers. This correction does not change the revenue requirement. Supplemental Staff Comments at 3.

C. Capitol Water Reply Comments

The Company concurred with the adjustments proposed by Staff. As discussed in more detail above, however, it requested two further adjustments.

With regards to the vehicle expenses (*supra* page 4), 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." Reply Comments at 2. 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. *Id.*

The Company does not oppose Staff's proposal (*supra* pages 8-9) to not include April in the summer month's rate. In addition, the Company agreed with the Staff proposal to eliminate Schedule No. 3 that covered the public fire hydrant and to shift those costs to the general ratepayers. Reply Comments at 3.

STAFF-COMPANY RECOMMENDATIONS

In summary, the Staff-Company recommendations are as follows:

1. Increase revenues by $148,908 or 31.3% to recover the revenue requirement of $624,713 (if all adjustments are accepted).

2. Eliminate Schedule 3 (Rates for Public Fire Hydrants).

3. Discontinue charging excess power costs (Idaho Power PCA related expenses) and the cost of purchasing sequestering chemicals (phosphates) to the Surcharge account as these expenses are built into general rates proposed by Staff.

4. Adjust vehicle expenses to 50/50 between personal and business use in test year.

5. Maintain the current summer rate schedule by not expanding the schedule to include April.

6. File tariffs incorporating Staff's recommendations for Schedule No. 1 (Non-metered Customers), Schedule No. 2 (Metered Customers), and Schedule No. 4 (Fire Sprinkler Systems and/or Inside Hose Connections) as described in the rate design section above and as set forth on Attachment A to the Supplemental Comments.

7. Not meter the system at this time but that the Company continues to advise its customers of the importance of water conservation.

DISPUTED ISSUE

1. Staff recommends that logbooks be used to record future use/costs of the vehicles, but the Company objects to using logbooks and proposes to use the 50/50 split.

COMMISSION DECISION

Does the Commission desire to approve a revenue requirement increase for Capitol Water of $148,908 to recover a total revenue requirement of $624,713? Does the Commission approve the Staff's proposed rate design? Is there anything else the Commission desires to do regarding Capitol Water's Application?

Don Howell

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Cecelia A. Gassner

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Table 1: Current and Proposed Base Rate Design

Schedule 1	Service Size	Current Tariff	Company Proposed Tariff	Staff Proposed Tariff
		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		Staff Proposed Tariff	
		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 ft³: $0.85 per 100 ft³	$ 6.77	First 1,000 ft³: $1.04 per 100 ft³	$ 7.70 (Includes 700 ft³)	First 1,000 ft³ over minimum charge: $1.18 per 100 ft³
	1"	$ 7.78		$ 9.51		$ 10.80 (Includes 1,000 ft³)	
	1 1/2"	$11.37	Second 1,000 ft³: $0.48 per 100 ft³	$ 13.90	Second 1,000 ft³: $0.59 per 100 ft³	$ 15.80 (Includes 1,600 ft³)	Second 1,000 ft³ over minimum charge: $0.67 per 100 ft³
	2"	$19.62	Remaining ft³: $0.36 per 100 ft³	$ 23.98	Remaining ft³: $0.44 per 100 ft³	$ 27.30 (Includes 3,800 ft³)	Remaining ft³ over minimum charge: $0.50 per 100 ft³
	3"	$35.20		$ 43.02		$ 48.90 (Includes 8,100 ft³)	

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

Schedule 4	Service Size	Current Tariff	Company Proposed Tariff	Staff Proposed Tariff
		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